S. HRG. 99-1057

OVERSIGHT OF THE FARM CREDIT SYSTEM AND PRODUCTION CREDIT ASSOCIATIONS

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

MISSOULA, MT—APRIL 8, 1985

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

U.S. GOVERNMENT PRINTING OFFICE

69-216 WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S161-13

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

JESSE HELMS, North Carolina, *Chairman*

BOB DOLE, Kansas
RICHARD G. LUGAR, Indiana
THAD COCHRAN, Mississippi
RUDY BOSCHWITZ, Minnesota
PAULA HAWKINS, Florida
MARK ANDREWS, North Dakota
PETE WILSON, California
MITCH McCONNELL, Kentucky

EDWARD ZORINSKY, Nebraska
PATRICK J. LEAHY, Vermont
JOHN MELCHER, Montana
DAVID H. PRYOR, Arkansas
DAVID L. BOREN, Oklahoma
ALAN J. DIXON, Illinois
HOWELL HEFLIN, Alabama
TOM HARKIN, Iowa

GEORGE S. DUNLOP, *Chief of Staff*
J. ROBERT FRANKS, *General Counsel*
CARL P. ROSE, *General Counsel and Staff Director for the Minority*
WARREN B. OXFORD, *Printer/Chief Clerk*

CONTENTS

Page

Melcher, Hon. John, a U.S. Senator from Montana, opening statement 1

CHRONOLOGICAL LIST OF WITNESSES

Orrick, Robert, Assistant Director, Office of Examination and Supervision, Farm Credit Administration 3
Haslebacher, Al, Vice President, Farm Credit Banks of Spokane 9
Olson, Rod, Executive Vice President, Farm Credit Banks of Spokane 12
Kelsey, Herb, Acting President, Bozeman Production Credit Association 14
Rupe, Jack H., representing Western Montana PCA Stockholders Committee 22
Deschamps, Robert, Jr., Polson, MT 25
Lawyer, John N., Plains, MT 27
Roth, Mike, Vancouver, WA 30

APPENDIX

Baucus, Max, a U.S. Senator from Montana, letter dated April 5, 1985, to Senator Melcher 35
Orrick, Robert, Assistant Director, Spokane Office, Farm Credit Administration, prepared statement 35
Haslebacher, Al, Vice President of Communications and Legislative and Public Affairs, Farm Credit Banks of Spokane, prepared statement 38
Olson, Rod, Executive Vice President of Credit and Supervision, Farm Credit Banks of Spokane, prepared statement, with attachment 39
Lawyer, John N., Plains, MT, prepared statement 44
Roth, Mike, Western Washington Production Credit Association, material inserted by: statement of Donald Wilkinson before House Agriculture Subcommittee on Conservation and Credit, March 26, 1985 52
Lawyer, David A., Plains, MT, letter of April 8, 1985, to Senate Agriculture Committee 55
Lawyer, Esther, Plains, MT, letter dated April 1985, to Senate Agriculture Committee 56
Western Montana PCA Stockholders Committee, list of demands 57

OVERSIGHT OF THE FARM CREDIT SYSTEM AND PRODUCTION CREDIT ASSOCIATIONS

MONDAY, APRIL 8, 1985

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Missoula, MT.

The committee met, pursuant to notice, at 10 a.m., in the Carousel Lounge, Hon. John Melcher presiding.

Present: Senator Melcher.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM MONTANA

Senator MELCHER. Good morning. This is a hearing of the Senate Agriculture Committee. I will be the only member of the committee present, but we'll be taking a record of the hearing, and it will be reviewed by other Senators on the Senate Agriculture Committee to determine the direction in which the Farm Credit System is heading. I am particularly concerned with the PCA's that are involved in liquidation here in Montana. This situation is of grave concern to the committee, as we enter into the spring of 1985, because without adequate credit, agricultural producers will not be able to continue in operation.

The problem isn't simply one of meeting the first surge of credit needs for this spring of 1985. However pressing that is, the committee must be cognizant of what direction the Farm Credit System as a whole, and farm credit in general, may take for agriculture producers during the coming years.

The three PCA's that are in liquidation here in Montana unfortunately places our State right at the focal point on what should be done for and about the Farm Credit System.

There are major concerns. First of all, concerns about the B stock: borrowers who have invested in B stock, as is mandatory with PCA loans, and who are members of the PCA's that are in liquidation, are being told that the value of that B stock cannot be determined until the entire liquidation process has been completed.

I don't believe we can accept that, for a couple reasons. For PCA's that have undergone liquidation up until now, it's my understanding that the B stock was made whole. In other words, all of it was paid back at full value. Without that being done for these three PCA's here in Montana—Western Montana, the Milk River and the Glendive PCA's—the confidence in PCA's all over the country could be severely jarred. It isn't just a question of determining the equitable thing for these particular owners of B stock

and these three liquidated PCA's. The equitable situation for them, obviously, is to pay full face value of that B stock. But, for the credibility of the entire Farm Credit System, the PCA's, the Federal land bank and the bank of the cooperatives, it is essential that, on mandatory purchases of B stock or any other similar devices where the borrower must purchase that stock, the B stock should never be put in a position of jeopardy or position of risk.

Now, if we start to unravel one PCA at a time, if a PCA goes into liquidation and the B stock isn't honored, then the entire Farm Credit System starts to unravel. I don't want that to happen.

We've learned a very valuable lesson over the past 60 some years. The Farm Credit System can be a real blessing for those individual borrowers who participate in borrowing. Also, those monies, making those loans or applying for those loans and being approved, are a benefit to the local communities that depend upon agriculture, and to the entire country where agriculture still is the most basic industry of our entire economy. I want to see the Farm Credit System preserved, continue to be viable, and continue to be the main post, the anchor for the entire system of providing credit for agricultural borrowers.

Here in Montana, I believe it's fair to say that half of the agriculture operating loans are made by PCA's. If the PCA's are not viable ongoing operations, the pressure on the commercial banks will probably become such that it will be more than they can adequately service, that is to reasonably provide loans on the basis of good terms and decent interest rates.

The Farmer's Home Administration is the lender of last resort. It takes on a farmer borrower after it is clear there is no credit available for that individual borrower, either from a PCA or from a commercial bank. The Farmer's Home Administration today finds itself far behind in its work and unable to keep up with all of the applications that are before it now. What all that indicates is a need for PCA's to be in a strong financial position. We need PCA's able to retain the customers they now have, and we also need them to be in position to take on new customers as those needs arise.

The underlying proposition for the entire Farm Credit System is to provide agriculture with a line of credit. We want to continue that to be its main focal point and have the system capable of doing so.

Another point I want to raise is that the towns and cities in Montana are very dependent upon the agricultural industry. If the agricultural industry cannot be made viable, our towns and cities and all the people that are connected with them in agricultural business are seriously damaged. Throughout most of the country, everywhere that there is agriculture in the United States of America, these communities are under the same stress as our own communities here in Montana.

I fully realize that credit is not the number one problem facing American agriculture or Montana farmers and ranchers. The number one problem, of course, is the lack of profit. Farmers and ranchers do not receive a fair price for the commodities that are produced, so that people cannot today make a decent living from farming. This morning we're focusing on the availability of credit

for these producers, as a first step toward the point where we can have an improved agricultural price situation.

I will make a part of the record a letter submitted by Senator Baucus [1] who has been one of the most diligent of all the Senators in Washington working on the farm credit crunch.

We'll now proceed with the witnesses that are here. Our first witness is Robert Orrick, Farm Credit Administration. He will be accompanied by Herb Robbins of PCA congressional affairs in Washington. I believe, Mr. Orrick, you're stationed out at Spokane; is that correct?

Mr. ORRICK. That's correct.

Senator MELCHER. Please proceed.

STATEMENT OF ROBERT ORRICK, ASSISTANT DIRECTOR, OFFICE OF EXAMINATION AND SUPERVISION, FARM CREDIT ADMINISTRATION

Mr. ORRICK. Mr. Chairman, my name is Robert Orrick. I am the assistant director and leader of the Spokane District Team stationed in Spokane, Washington. To my right is Herb Robbins who is a member of the Congressional Affairs Department for the Farm Credit Administration from Washington, D.C. Mr. Chairman, I have submitted for the record a copy of my testimony. With your permission, I will summarize the key elements of this testimony.[2]

It must be understood what is occurring in the Northwest is not unique. The problem of failing production credit associations is more severe in the Northwest thus far, however, there are other districts that have had PCA's go into liquidation. The same is true with the Spokane district's proposal to merge all the district's PCA's into one association. A number of the farm credit districts are considering broad merger and consolidation plans.

It is also important to understand that what happens in the Spokane district affects all 37 farm credit banks. System securities are sold on the bond market on a system-wide basis. This means that all 37 banks stand behind the bonds sold to make loans for each bank. A system-wide capital preservation program exists to ensure that one bank—when one bank cannot meet its obligation, the other banks will see to it that the bond holders are repaid. Right now, the Federal Intermediate Credit Bank of Spokane is operating under an interim financial assistance plan which involves contributions of funds from the other 36 banks in the System.

The Farm Credit System institutions provide 100 percent of their lending for agriculture, aquatic and rural housing purposes and for rural electric cooperatives. In the Northwest, eight PCA's have gone into liquidation, four of them this year. Two PCA's in Nebraska and one in Kentucky are also being liquidated. In addition to the problems being experienced by the FICB in Spokane, we expect at least one other FICB to need help in 1985.

The System, as a whole, nevertheless, is financially sound. Despite $407 million in loan losses in 1984, the farm credit banks posted $441 million in earnings. Reserves for losses at the bank level actually increased.

---

[1] See p. 35 for the letter from Senator Baucus.

[2] See p. 35 for the prepared statement of Mr. Orrick.

It is important then to review the Farm Credit System problems and concerns in the context of agriculture generally and of the Nation as a whole, rather than restricting our view to one section of the country or several institutions within the Farm Credit System. It is also important to learn from the experience of failed institutions, and put in place mechanisms for preventing further deterioration.

Unfortunately, the Spokane district provides examples of what has gone wrong, and provides the basis for developing solutions that can prevent liquidations elsewhere.

The Farm Credit Administration has the responsibility for overseeing the liquidation of failed associations. We are, in fact, presently conducting on-site inspections of institutions being liquidated. The standards applied by liquidators are no different than those applied by other Farm Credit System lenders in the district. There are some that feel the liquidators are playing a more rigid and restrictive standard. But to a large extent, the problem was a too lenient credit policy being administered by the association that is being liquidated. As long as the liquidator is using sound business practices in discharging his functions, FCA will not intervene.

The financial assistance being supplied to the Federal Intermediate Credit Bank of Spokane is helping to keep the interest rate down in the farm credit district. One of the negative effects of association failure is that FICB loans are not repaid and result in significant losses that must be recovered by increasing the cost of money to the remaining PCA's.

Senator Edward Zorinsky of Nebraska has introduced S. 466 which would grant to FCA the same intermediate enforcement authorities currently exercised by other regulators of Federal financial institutions such as the Comptroller of Currency Control, the Federal Home Loan Bank Board and the National Credit Union Administration. Specifically, the bill would grant FCA authority to issue cease-and-desist orders, levy civil penalties, remove officers and directors of the System institutions, and sue and be sued. They would increase our ability to protect shareholders of farm credit institutions, while granting the institutions increased freedom from FCA regulation of ordinary business decisions, and protect their right of appeal of such FCA actions.

Presently, FCA has limited enforcement powers, some of which can only be used as a last resort. It may, with the concurrence of the district board, require merger when it determines that an association has failed to meet its obligations or conduct its operations in accordance with the act. And, upon default of any obligation, a System institution may be declared insolvent by the Governor of the Farm Credit Administration and a conservator or receiver may be appointed.

At present, the Farm Credit Administration can only take action after the damage has been done. Thus, unsafe, unsound practices identified by FCA or the banks in their supervisory capacity cannot be remedied under current authorities until those practices result in insolvency, and then the remedy is to place the institutions into receivership or to merge it.

The Farm Credit Administration possesses a variety of approval authorities which, together with the supervisory activities and ex-

amination of banks and associations, are tools for discovering and correcting problems before the institution becomes insolvent. But none of these tools carry with them the power of enforcement. So they are, essentially, means for persuading.

These new intermediate enforcement authorities would permit FCA to stop or alter a course of action by a bank or association which is unsafe, unsound, threatens the strength and stability of the financial institution, or violates law and regulation.

One further point. FCA endorses the concept of a Federal mechanism to protect against the market distortions that can occur from liquidation of nonperforming assets. We believe that the volume of such assets that will come onto the market in some areas, will otherwise cause an overadjustment in the asset prices, destroying not only the market values for all agricultural real estate in an area but the balance sheet of salvageable farm business as well.

A second effect of carrying nonperforming assets is to drive up the interest costs on those loans that are nonperforming. The result is a limited capacity of such institutions to hold acquired property off the market, and a greater instability of land values as a result.

In summary, it should be understood that agriculture and those that serve it are going through a difficult time of adjustment which is far from over. Some farmers will fail and so will some financial institutions and other businesses who serve farmers. One clear lesson that has been learned because of the Farm Credit System's problems in the Spokane district is that the Farm Credit Administration needs enforcement authorities which can be utilized before promises become so severe that associations are unable to recover.

Senator MELCHER. Well, thank you, Mr. Orrick. You mention in your testimony that Farm Credit System is a cooperative system. In that light, I want to ask a couple questions regarding the B stock repayment.

As the leader of the team for PCA's involved in the Federal Intermediate Credit Bank in Spokane, have you run across the concern of PCA members as to what happens to the B stock in these liquidated PCA's?

Mr. ORRICK. Yes, sir. In every instance—or any instance, the borrower's our concern.

Senator MELCHER. Now, am I correct that in all the liquidations that have occurred up until now, the B stock repayment was made in full?

Mr. ORRICK. There are eight associations currently being liquidated in this district, and that is not the case in each association. Nor is it the case in the other three PCA's being liquidated within the System.

Senator MELCHER. I'm referring to those PCA's where liquidation has been completed.

Mr. ORRICK. With the first four that went into liquidation within this district are the ones that you are referring to; is that correct?

Senator MELCHER. Yes.

Mr. ORRICK. I believe those are the Will Lambett, the Southern Oregon——

Senator MELCHER. Idaho.

Mr. ORRICK. Southern Idaho, correct, yes.

Senator MELCHER. Well, let's take Southern Idaho. That's the closest one to us in many respects. Were those B stock holders paid in full?

Mr. ORRICK. Their B stock was guaranted by the bank.

Senator MELCHER. Absolutely guaranteed. So they'll be paid in full?

Mr. ORRICK. Yes, that is my understanding.

Senator MELCHER. What's the difference between the Southern Idaho and Western Montana PCA's?

Mr. ORRICK. It's the bank's prerogative to guarantee the B stock, if they so desire.

Senator MELCHER. Well, that's what I'm asking. Why don't they desire to guarantee the B stock of the Western Montana PCA's?

Mr. ORRICK. Because of the initial cost to the bank.

Senator MELCHER. It would cost more here than it did in Southern Idaho?

Mr. ORRICK. The bank at this time is in a weaker position.

Senator MELCHER. Well, that isn't the question. Would it cost more?

Mr. ORRICK. Depending on the number of borrowers.

Senator MELCHER. Would it not be about the same or maybe a little bit less?

Mr. ORRICK. I don't have that information.

Senator MELCHER. Can you supply it for the record?

Mr. ORRICK. Pardon?

Senator MELCHER. Would you supply that information for the record?

Mr. ORRICK. Yes.

Senator MELCHER. Now, we get to this point about grass roots control. To many people it looks like the reorganization of the Federal Intermediate Credit Bank in Spokane is going to set up a giant PCA. How are you going to overcome that feeling?

Mr. ORRICK. The grass roots control, the plan that is before the associations presented by the bank, will provide input at the grass roots level.

Senator MELCHER. Input, you know, is like sending a letter to Washington. I think a lot of the letters, when you're borrowing money you'd like to know more than your own views. What's going to happen with the whole cooperative system sort of based on local control? What control are farmers going to have other than just input?

Mr. ORRICK. The election of the directors of the continuing association will be provided on a regional basis. And so those individuals will have a voice on the board of directors of the PCA.

Senator MELCHER. If I have a loan, say, up in Conrad, who would I be voting for, one director from Montana, one from the Conrad PCA, or what?

Mr. ORRICK. You would be voting for the one director for the servicing area.

Senator MELCHER. How big is that area?

Mr. ORRICK. I don't have those particulars. We can provide that for you.

Senator MELCHER. Well, perhaps the next witnesses would be in better position.

Mr. ROBBINS. They would, sir. And the point is that the Farm Credit Administration's role is not to organize the system institutions, but rather to see to it, one, that all eligible borrowers are serviced and, two, that the institutions are viable institutions from an economic point of view. The organization and service is really a matter for the district boards to determine. It's probably more appropriate to question the bank on this and the PCA's, because of the limited role that the Governor has in determining the chartering of these institutions.

Senator MELCHER. For the record, of course, this is Herb Robbins. Herb, will you tell us what your function is in Washington?

Mr. ROBBINS. I'm in the Congressional and Public Affairs Division, and I work on congressional affairs matters.

Senator MELCHER. You lobby strong.

Mr. ROBBINS. That's right, sir.

Senator MELCHER. You lobby both House Members and Senators.

Mr. ROBBINS. Yes, sir.

Senator MELCHER. Do you also present the Farm Credit System's position on legislation?

Mr. ROBBINS. That's correct.

Senator MELCHER. So you'll be lobbying hard on the bill that has been mentioned, S. 466.

Mr. ROBBINS. Yes, sir.

Senator MELCHER. Herb, how are you going to answer questions that Senators and Congressmen ask you such as, "If you don't pay off the B stock of liquidated PCA's, how is anybody else going to feel comfortable borrowing money from a PCA that is not under liquidation?"

Mr. ROBBINS. The essential purpose of the enforcement powers is to give credibility to the oversight of these institutions by the Federal Government so that borrowers who are also member/owners of the associations can have some security that there is—that the practices of the institutions are safe and sound. That is not to say that supervisory procedures being carried out now don't point up problems. But there is no enforcement for it.

It is true that the stock is at risk. That is to say that it is used as capital for the System and, as such, it must be at risk. It is not a bank loan. The fact is, if you go to the bank, you don't have to buy stock in the bank to borrow. In this system, when you borrow, you become an owner as well, and you put up capital, which is at risk.

Senator MELCHER. Well, how are you going to answer the question, though? Because it is a question that you'll be asked. How can the System retain the confidence of the borrower? After all, that borrower is a customer. Very few customers exist that want to put up 10 percent of liability to get a loan at the same rate of interest they can get from a commercial bank.

Mr. ROBBINS. The key question is safety and soundness. If the institutions are run on a safe and sound basis, then the investment that the member/borrowers put into their associations will be safe. If they're not run on a safe and sound basis, then we will lose borrowers. The System will lose borrowers because there will be a lack of competence in that System.

Senator MELCHER. Well, you seem to imply that more regulation is needed that means more power in the hands of the Farm Credit

Administrators. That isn't the point of my question. I think the question is more basic and more practical. The question is, how can you retain the confidence of borrowers if, in these PCA's that are being liquidated, the B stock is not going to be repaid in full? If you just want to say you don't know how you're going to answer that question, just say so and we'll get on with it.

Mr. ROBBINS. Well, I think some things are separate institutions. The fact that some have failed and that there is danger to those members of failed institutions of losing part or all of their investment, does not necessarily carry over to the other institutions, if those other institutions are sound.

Senator MELCHER. Let me point out this is a cooperative system. The B stock you say can be put at risk. It certainly seems to be at risk, except in the case of liquidation where B stock is paid out in full. How do you attract customers to take a risk when many of them, probably most of them, can get a commercial bank loan at the same rate of interest without risk?

Mr. ORRICK. The B stocks to which you refer is, in fact, risk capital to capitalize the System. The borrower, through his election of directors, insures the prudent business-like operation of the PCA. And through that, he protects his B stock.

Senator MELCHER. Well, I might point out, Mr. Orrick, that you can't get bills passed in Congress, you can't lobby Congressmen and Senators without answering their questions.

I want to stress right here that I don't believe that these answers are at all satisfactory, and that you're going to have difficulty retaining your customers who may believe that B stock is at risk. Some of them are going broke. If you're not losing customers already, you're going to start losing then. When you lose all the good credit risks, I don't know how any cooperative can function. Right now borrows from the PCA's that aren't under liquidation have a feeling that B stock is truly risk capital, all right. They may so choose to go somewhere else. That's the unraveling effect that I'm concerned about. If we're going to retain this Farm Credit System, we can't allow it to start unraveling. You say you had about $466 million in reserves or profits last year, and you have higher reserves than you did before. That's all very fine, and I'm glad to hear it. However, what's the total of the Farm Credit System in capitalization?

Mr. ORRICK. In capitalization or loans outstanding?

Senator MELCHER. Capitalization.

Mr. ORRICK. About $8 billion.

Senator MELCHER. About $8 billion. And in loans outstanding

Mr. ORRICK. Loans outstanding is slightly less than $70 billion.

Senator MELCHER. All right. So in capitalization, $466 million looks decent compared to the $8 billion. But when you start looking at outstanding loans of $70 billion that isn't a whole lot of money in reserve.

I think you've got a further problem when you approach Members of both the House and the Senate to lobby for a bill. Congressmen are going to want to be assured that the whole System isn't collapsing, and that the people involved in it, whether it's the PCA in Montana or Nebraska or Kentucky or PCA's anywhere else throughout the country going in the right direction.

Mr. Robbins, has the Farm Credit System testified on the farm bill, yet?

Mr. ROBBINS. Yes, sir, they have.

Senator MELCHER. What did you testify?

Mr. ROBBINS. Well, we testified on the question of enforcement power. We testified on several other matters. We testified about the B stock issue. It happens that in February the Federal Farm Credit Board asked the Farm Credit Administration to do a study on the feasibility of an FDIC type insurance plan for class B stock. This past week, the study was presented to the board, there was a debate, and the board determined to set the matter aside and not to look further into it at this time.

There are some very difficult technical problems that have not been resolved on this issue.

Senator MELCHER. Well, I suspect that those technical problems might be resolved before we have the farm bill on the Senate floor; isn't that correct?

Mr. ROBBINS. It would be very good if it could, and it would be even better if there would be some way to solve the problem for those people who's stock is presently in jeopardy. I don't, at this point, see that happening.

Senator MELCHER. Well, I hope it happens, because we can either work out the terms in the bill, the language, and the way it affects the Farm Credit System, or we can write it on our own.

I think that's all the questions I have of both of you. I appreciate very much your attendance here at this hearing and your willingness to testify. Your comments will be read by other members of the committee who want to know what's going on in this Spokane district, and how the restructuring of the PCA's in this district is going to be accomplished. Thank you very much.

Mr. ROBBINS. Thank you, sir.

Senator MELCHER. Our next panel of witnesses consists of Rod Olson, the executive vice president of credit and supervision of Farm Credit Banks of Spokane, Al Haslebacher, vice president for legislation and public relations Spokane Bank, and Herb Kelsey, acting president of the Bozeman PCA. Do you have copies of your testimony?

Mr. HASLEBACHER. Yes, sir.

Senator MELCHER. Can we provide the reporter with copies?

Mr. HASLEBACHER. The copy is for your committee.

Senator MELCHER. Rod, are you first?

STATEMENT OF AL HASLEBACHER, VICE PRESIDENT, FARM CREDIT BANKS OF SPOKANE

Mr. HASLEBACHER. Mr. Chairman, I will lead off. As you know, my name is Al Haslebacher, vice president for legislative and public affairs for the Farm Credit Banks in Spokane.[1] With me is executive vice president Rod Olson, for credit and supervision, and Herb Kelsey, acting PCA president for the Bozeman PCA. We have written testimony that we have presented, and would like to sum-

[1] See p. 38 for the prepared statement of Mr. Haslebacher.

marize that in brief comments. My purpose is to give a few brief overview remarks to put this hearing in perspective.

Mr. Chairman, you, yourself, have noted that we have a farm income problem. I'd like to state very clearly that what we really have is a farm income problem not a farm credit problem. We've had 5 years of continually declining farm net income, and a dramatic reduction in farm asset value which has sharply reduced the basis for financing by farmers. The resulting stress from this has severely impacted the highly-leverage farmer and every institution that has heavily invested in agriculture which includes not just farmers but country banks, Farm Credit Associations and agricultural businesses.

As we talk here today, we note this stress particularly is affecting the Farm Credit System in this country and the associations composed of it, and that's because we are single-industry lenders, 100 percent of our loan assets are in agriculture.

We note that some people question why Government has any responsibility in assisting farmers in these times. Farmers who, according to Mr. Stockman, made adult decisions to expand further into debt in the mid and late 1970's. Well, we need to stress that they didn't count on the grain embargo; they didn't count on the value of the dollar reaching record levels and essentially taking us out of the foreign markets; and they didn't count on the record high interest rates that we're paying in our farm borrowing, nor in Montana, the successive years of droughts. And yes, neither did they or their lenders or Congress, the extension service, the farm press, people who are considered advisors, count on these occurrences, many of these people who counted on expansion during the golden era of agriculture in the early 1970's.

But it's now 1985, and the studies that we've seen indicate that about 30 percent of the farm debt in this country is in the hands of somewhere between 12 and 15 percent of the borrowers who have at least a 70 percent debt asset ratio.

This is the volume of the farm debt that will almost certainly face liquidation in the next several years unless the agricultural economy turns around. In addition to these highly stressed and leveraged farmers, the current stress affects the agricultural infrastructure the local feed stores, the cooperatives, the country banks, the implement dealers, and as we've talked this morning, yes, the PCA's, all of whom would depend on a prosperous agriculture. I'm sure you've noted that 2 weeks ago in the Great Falls Tribune there was an article citing a Federal reserve report which said, fully 10 percent of Montana's banks are jeopardized by loan losses. These are commercial banks. Those banks with a higher percentage of agricultural loans are in the greatest jeopardy.

As these institutions are impacted, as they suffer the cost of losses on receivables or loans, the higher costs are spread out among the rest of the farmers, among those that aren't highly leveraged. It is they who will pay the added cost until they, too, are unable to service their debt or take their business elsewhere to the regional suppliers and the big city banks and have a base outside of agriculture.

We cannot ignore the fact that there's a major transition occurring in U.S. agriculture, in it's structure, production capacity and

its markets. But it's essential that this transition be evolutionary rather than revolutionary. And by that I mean not over night or in 1 or 2 years.

We believe, therefore, there must be time for the transition, and some type of Federal program to accomplish this transition will be required. Because no amount of restructuring, interest rate write-downs or forbearance can save very many, if any, of this highly leveraged group unless there is an increase in net farm income.

Mr. Chairman, borrowers never believe that forbearance comes soon enough for them or lasts long enough. But there is a cost of time where money is concerned, and that's a cost of forbearance. The Farm Credit Banks have carried out a specific policy of forbearance the last 3 to 5 years, waiting and hoping for restored profitability to agriculture. While we have been forbearing and waiting, we've see farmers lose the equity that they've had in their business, equity that many could have salvaged had they liquidated 3 to 5 years ago. But the equity is now eroded by increasing debt service costs and depleted land values. In many cases PCA loan officers not only have gone the extra mile with their borrowers, but have gone to the end of the road to the detriment of both the borrower and the lender.

We have seen some lose their farms. Now a PCA member's fellow borrowers are paying the increased interest rate that must be charged if a lender is to cover the cost of carrying those farms on their books. That's what they'll have to do. Because there is essentially no market for these farms. The higher interest rate only increases the debt service burden of the other farmers, thus, weakening their own financial condition. There comes noncompetitive and borrowers who can find another lender will flee, thereby imposing even greater interest costs on those remaining.

Mr. Chairman, the Farm Credit System banks and associations can justify some additional forbearance to its stockholder/borrowers, and to the investors on whom they rely, but only in the context of restored profitability on the immediate horizon.

However, we do not see it. Instead, we see loan officers who are trying to rewrite their operating loan to the prospect of massive withdrawal of Government support in agriculture. We also see an administration that has proposed a $50 million tax on farmers' access to the agency market, rising to $75 million in 1987. Apart from the revenue this will raise, the express purpose of OMB and the administration is to drive the Farm Credit System out of the agency market. They call it a user fee for which the farmers get nothing in exchange except a higher interest rate bill.

I think we all agree that credit is one of the most important tools in a farming business and you, yourself, have noted the PCA and the Farm Credit System must be kept strong. It is the primary access that farmers have to the Nation's money market.

We cannot stress enough that as agriculture goes, so will the institutions of the Farm Credit System go. We have done much in recent months to mobilize the capital of our association to best assure the viability of our troubled institutions around the country. We believe we can deal with the problem. However, the big challenge is to stop the deterioration in those credits who do have a chance to survive in farming business. If we are to do that, the ag-

riculture industry needs some assurance of return to profitability and the stability of a long-term farm program that will provide time for the overleveraged farmers to transit out of agriculture.

Mr. Chairman, that's an overview we would like to give of what we see as the problem. We commend you for showing your interest in the agricultural stress by holding this hearing, and we know you will do your part in Congress to assist in solving this part of the equation. At this time, Mr. Olson has some specific comments to make about some of the issues you've asked about.

Senator MELCHER. Mr. Olson.

STATEMENT OF ROD OLSON, EXECUTIVE VICE PRESIDENT, FARM CREDIT BANKS OF SPOKANE

Mr. OLSON. Yes, Mr. Chairman. I'm Rod Olson.[1] I'm executive vice president of the Farm Credit Banks of Spokane. We do appreciate your attendance, Senator, at these hearings to hear about agricultures' problems. I think that we've all stressed that income is the problem. We need higher calf prices, higher wheat prices and so on, if we are going to turn the tide of the ills in agriculture. We too, are borrowers as banks of the Farm Credit System. We borrow funds from the agency market and we have to repay those loans just as we require our borrowers to repay. We pledge notes and mortgages to the investing public, for which they give us the funds that we can have to reloan to agriculture in the Northwest and the rest of the Nation's agriculture.

As we progress on this kind of thing, the areas problems, if we are not able to pay our interest bill, we have no choice but to collect on the loans that are not paying their interest bills.

The Federal Intermediate Credit Bank of Spokane currently is in a financial crisis as well. The nonperforming loans of the PCA's and the credit bank caused a $22 million loss in operations for last year, 1984. Beyond that, one of the big problems is the nonperforming loans in our portfolio, those loans that we are paying interest on the bond market but not receiving interest in our operations. These loans are causing the stress in our district at this time.

As the local boards of directors of our PCA's looked at their financial situation this past year, particularly these associations that we're discussing in Montana, after review of their financial affairs, they agreed that voluntary liquidation was the best chart of—or best course that we could chart for the future of these associations. They did this to accomplish several things. I'd like to recite three things out of the liquidation plan that were paramount in their concern. Number one, to maximize the return from the association assets and minimize losses to its creditors; two, to focus both on the collection and/or improvement which will allow collection or reclassification of some of these nonperforming loans so that they may be turned into viable loans for other associations; and three, to safeguard against any fire sale approach to liquidation.

The priorities for distribution of the assets of any liquidation go first to administrative expenses, they go secondly to secured creditors, third to general creditors, and then member equities. The liti-

---

[1] See p. 39 for the prepared statement of Mr. Olson.

gation that we are faced with in this district may cause delay in accomplishment of liquidation goals, but it probably will not change them. Litigation becomes an administrative expense that the liquidating PCA has to burden.

In the western Montana situation, we began the liquidation with 515 active loans. Approximately 215 of those accounts were offered service with the expanding PCA neighbor the Bozeman Montana PCA. We have had 86 members acceptance to move to the Bozeman PCA. We are presently reviewing the entire remaining portfolio, and there is an estimate that there could be as many as 100 other accounts that will be viable through restructuring and can be moved into the adjoining PCA.

We've heard a lot of comments about the foreclosures that have taken place during this period of time, and in all of the liquidations in Montana there have been only two foreclosure actions started since the inception of the liquidation.

One of the major issues that you have earlier brought up is the borrower stock issue. We know that it is of grave concern to members and it is very concerning to us as well.

The capital position of the Farm Credit System has a long history of being funded or capitalized through member equity, through stock purchase. This goes back to 1916 with the formation of the Federal land banks and then into the 1930's when the formation of the PCA's and the BC's occurred. The case books are full of stock litigation which has established the risk nature of this stock as the System's capital.

Because of the issues that have come before us in the past year and a half, back in February of 1984 we sent out a brochure to all PCA's focusing on the stock issue and just exactly what it was. I'd like to read from this just one short paragraph as to the B stock. It states, "that because B stock comprises a portion of the PCA's capital base, there is a possibility that automatic retirement could be cancelled or the stock could become impaired." This was sent out to clarify, if there was confusion, the capital nature of this stock.

The second major issue concerning the stock is why four liquidated PCA's stock was allowed to be retired and in the last four liquidations it was not. If we go back to the time frame when the first four liquidations were occurring, the FICB, with the concurrence of FCA, made a business decision to write down its loans with the Puget Sound PCA, Southern Idaho PCA and Southern Oregon PCA to a level which eliminated any risk to the A or B stock to the members. This cost the Federal intermediate credit bank approximately $9½ million.

After these last four liquidations, the bank's current financial condition and projected losses necessitated a business decision that prevented us to do the same thing that we've done in the first four associations. The estimated cost to the credit bank, if we were to write down our loans to the four recently liquidated PCA's, which would in essence guarantee or allow retirement of stock, would be around $16 million. This is a sum of money that the credit bank cannot afford today.

I think, after all of this discussion as to what has happened, I'd like to visit a little about what we have planned. Number one, we do need assistance in this district, and we've gone to the other

banks of the Nation and asked for their help. To date we have a $25 million interim assistance program in place, and it is being utilized in this district. This money is being put up by the other banks of the Nation to cover our monthly operating losses until we can get a long-term program in place, which will turn the tide for this district. They're talking in terms of up to $300 million in assistance, and this is basically going to be through the assistance of other farm credit banks in purchasing the high-risk loan portfolio in this district. The other banks of the Nation have asked that we do several things if they are going to assist. Number one, to increase our efficiency to the utmost, and they believe through a one stop credit system being the way to go. They believe that we need to gather our capital in PCA so that we maximize our risk taking ability. This is why we're talking about merger of PCA's down into one. To date, we have had system committees of directors and management from the field helping design this program. Sixty-two of 63 associations, PCA's and Federal land bank associations in this district have gone on record of supporting proceedings to the stockholders of their associations with a merger vote to move into one PCA and one FLBA.

We have consolidated into joint management at the bank level so that we can maximize our efficiencies there as well. We believe that we need the most effective, cost efficient use of staff, capital and resources in this district to meet the goals.

Mr. Chairman, the lending industry, along with the agricultural industry, is suffering financial stress at record levels. We believe the Farm Credit System, however, can solve its own problems and weather this economic storm by providing for the transition taking place in agriculture, and we believe it should be through evolutionary rather than revolutionary means. Therefore, we urge you and your colleagues in Congress to pursue any moderate courses of action to assist this. Thank you.

Mr. HASLEBACHER. Mr. Chairman, at this point Herb Kelsey of the Bozeman PCA would like to give a brief update on how we're proceeding with serving the Western Montana PCA area.

Senator MELCHER. Mr. Kelsey.

STATEMENT OF HERB KELSEY, ACTING PRESIDENT, BOZEMAN PRODUCTION CREDIT ASSOCIATION

Mr. KELSEY. Mr. Chairman, I'm Herb Kelsey, acting president of the Bozeman PCA in Bozeman, Montana. My comments will be limited more to the direct situation that we have here in western Montana rather than on a perspective on a district-wide basis. The Bozeman PCA association involvement in the Western Montana PCA situation began in January of 1985, as a result of our local charter being expanded to encompass the area formerly served by Western Montana PCA.

This expansion of territory more than doubled the area that we had to service, and it presented a problem as to how best to serve a sound, constructive credit situation to the newly acquired area at a competitive rate and without negatively impacting the current situation in the Bozeman PCA. In an effort to reduce that initial start-up cost, the Bozeman PCA did enter into a service agreement

with the Federal Land Bank of Missoula, whereby the Federal land bank offices in Missoula and Kalispell would service the PCA accounts through the existing locations. This arragement allowed for the utilizations of current office space and manpower, although it did require the Federal land bank—or put them in a position to hire additional staff to deal with the increased loan activity.

The Bozeman PCA, coupled with the Federal Land Bank of Missoula and the Federal Intermediate Credit Bank of Spokane, began a review of all credit files in the Western Montana PCA liquidation. This review was intended to determine the number and amount of loans which may be eligible for potential transfer to the Bozeman PCA. The basis used to determine transferability of any particular credit was the current loan position, current financial position, the trend and the potential for continued operational viability. The Bozeman PCA also took into consideration the potential risk of any given credit to the financial position of the Bozeman PCA. The Bozeman PCA felt that it was not in a position to accept any credit which may be considered or cause undue risk to our association and its existing membership.

Although Bozeman PCA was and is in good financial position, any increase in questionable or high risk accounts could be very detrimental to the stability of the Bozeman PCA. Mr. Olson touched on the fact that as of to date we have sent out approximately 250 letters to former members of the Western Montana PCA indicating our desire to have them transfer their account to the Bozeman PCA.

He also mentioned that as part of that, we have recently gone back through the active loan accounts of the Western Montana PCA and have come up with approximately 100 to 120 accounts which, for one reason or another, were not acted upon during the initial review. Reasons being because of their timing in sequence in terms of renewals, possibly there was some documentation which needed to be updated and those files have just recently been completed. So there is a rather large number of loans that we have not actually made a selection on at this point in time.

I think the other thing that I would like to deal with is the potential—or the district merger plan which is being proposed at this point in time, potentially could have helped the Bozeman PCA situation in the current environment by the creation of a larger pool of risk funds. We have to be very selective. Although, like I said, we're in good financial position, we cannot afford a great amount of undue risk or we ourselves become in a very questionable position. So it did impact some of the credit decisions that were made.

I feel that the Bozeman PCA has given an honest and sincere effort to provide short-term credit to credit worthy loans currently in the Western Montana PCA liquidation. I feel that the arrangement we have made with the Federal Land Bank of Missoula has helped in impacting any cost which the Missoula people may have seen and, at this point in time, we are seeing our interest rate to the Missoula people the same as it is to our current membership. Thank you.

Senator MELCHER. Thank you, Mr. Kelsey. What is that interest rate?

Mr. KELSEY. Our current rate effectively in 13.64.

Senator MELCHER. Does that include the B stock?

Mr. KELSEY. That includes the cost of stock, yes.

Senator MELCHER. So it's 13 and two-thirds. Is that competitive with the rate charged by commercial banks?

Mr. KELSEY. It's in the competitive nature, but I would have to say it is probably somewhat to the high side.

Senator MELCHER. How many loans have you actually made to former Western Montana PCA members?

Mr. KELSEY. Actual transfers? Mr. Olson mentioned 86. the number is 56 as of today.

Senator MELCHER. That's roughly 10 percent of the 515.

Mr. KELSEY. That have actually chosen to transfer; that's correct.

Senator MELCHER. And what size are they?

Mr. KELSEY. Average loan volume number of that 56 would be somewhere around $30,000.

Senator MELCHER. That's a fairly small loan.

Mr. KELSEY. That's correct.

Senator MELCHER. For a farm or ranch operation.

Mr. KELSEY. But that is inherent in the Missoula PCA.

Senator MELCHER. What was the total amount of money loaned by Western Montana?

Mr. HASLEBACHER. $44 million at the time of liquidation—$44.9 million was outstanding December 31, 1984.

Senator MELCHER. About $45 million?

Mr. HASLEBACHER. Correct.

Senator MELCHER. And 56 times $30,000 would be roughly——

Mr. KELSEY. Million 7 approximately.

Senator MELCHER. Less than $2 million.

Mr. KELSEY. That's correct.

Senator MELCHER. So both from the standpoint of total number of members that were in Western Montana, that's relatively small. But even so, the 56 represents only about 5 percent then, less than 5 percent of the loans in Western Montana?

Mr. KELSEY. That's correct. But I think you need to expand that, in that we do have letters in the mail that have been received by approximately 250 people. It is their option whether they choose to transfer or not. Initial guesstimates that we had, based on some of the early work, was there was somewhere between $13 and $15 million tied up in those accounts. We have dropped our estimates based on the fact that there has been a reasonable amount of refinance through commercial banks. But I think we have made the effort to respond to those people. They have not chosen at this point in time to send the information back to us to allow us to go ahead and transfer their account.

Senator MELCHER. Well, let me point out that first of all, for somebody that is in farming or ranching today, in Montana in particular—but it's pretty general throughout the country—if all their credit need amounts to is $30,000 they are unusual. It seems to me that such a borrower is either pretty well off and with a debt-to-asset ratio that is insignificant, or else that borrower has another job and other income, and does not depend solely on agriculture for the family livelihood.

Is physical distance a part of this? I'm going to drive to Bozeman late this afternoon and get there sometime this evening, a drive of

210 miles or so. A PCA borrower in Western Montana PCA who lived up at Polson or Ronan would have to drive about an hour just to get into here with great threat to bodily injury on Route 93. Is that part of it, the fact that it's a long way?

Mr. KELSEY. I guess I don't think so. I think that first issue is that they can and will do their business out of the Federal land bank office in Missoula or in Kalispell. They do not have to come into Bozeman to transact their business. I think some of the issues raised in the previous conversations are part of it. Their stock is frozen, this hearing, where the Farm Credit System is, where this district is, are all concerns which I feel in a lot of cases are legitimate concerns. And given that,. I think there is some hesitancy within the membership of Western Montana PCA to transfer to Bozeman. I think that's more the issue than distance or convenience. Again, I think of the approximately 515 accounts, we have sent letters to 250 of them. so I think we've made the invitation. The hesitancy on that side is being seen by us at this point in time.

Senator MELCHER. Thank you, Mr. Kelsey.

Mr. Olson, you mentioned the litigation on having the B stock repaid in full. I don't, of course, want to put you in a position to respond to questions that you think hamper that litigation. But to the extent that you can answer, let's go into that a little bit.

The litigation is specifically on that point, whether or not the B stock will be repaid in full; is that correct?

Mr. OLSON. It's just the threat of litigation at this point, Senator.

Senator MELCHER. Well, all right. Is that what the threat is?

Mr. OLSON. From what I've heard to date, and of what correspondence we've received, it is the need of the members to guarantee the B stock as was done in the first four liquidations.

Senator MELCHER. What's your preference?

Mr. OLSON. What's my preference?

Senator MELCHER. If it is in litigation, you might not want to respond.

Mr. OLSON. Well, my preference would be to proceed with the liquidation to the point that we return as much of that B stock as possible back to the member through the liquidation effort.

Senator MELCHER. All right. Let's just narrow it down to the point of guarantee. I'm just going to assume that, if you could, you'd like to pay it all back; is that right?

Mr. OLSON. Yes.

Senator MELCHER. All right. Now, did you say it cost $15 million?

Mr. OLSON. Approximately $16 million is the estimate in the four remaining liquidations.

Senator MELCHER. All right. The fourth one is in Washington.

Mr. OLSON. Yes.

Senator MELCHER. So would not that put the Spokane bank in a better position to get it all paid back.

Mr. OLSON. Oh, yes.

Senator MELCHER. Why?

Mr. OLSON. Well, it would improve the image, number one.

Senator MELCHER. That's right. Because without image you're going to lose a whole lot of borrowers, are you not?

Mr. OLSON. There is concern by the borrowers, yes.

Senator MELCHER. Well, wouldn't it be fair to say there's a lot of concern in the Spokane bank too if those borrowers start leaving the System?

Mr. OLSON. Yes.

Senator MELCHER. How many have left the System?

Mr. OLSON. We don't have accurate counts on all of them because many are waiting right now in the renewal period, and so we don't know whether they're going to remain with the System or pay off with other lenders. But we have had a falling off of volume of approximately $200 million.

Senator MELCHER. $200 million?

Mr. OLSON. In this past year.

Senator MELCHER. And what percentage is that?

Mr. OLSON. Well, we were starting from a base of about a million two, and so we're talking about—less than 20.

Senator MELCHER. You've lost 16 percent—16 to 17 percent already?

Mr. OLSON. Yes.

Senator MELCHER. And do you know, are those the best, the most credit worthy borrows?

Mr. OLSON. I'd say for the most part, yes.

Senator MELCHER. Doesn't that further jeopardize the Spokane bank?

Mr. OLSON. It weakens, if you lose your better borrowers, yes.

Senator MELCHER. Well, I'm going to make an assumption. And if my assumption isn't correct, you better correct me immediately. I'm making the assumption that for the people that work in the Spokane bank, they're desperately hoping that something will happen to either convince, coerce or legislate the Farm Credit System into a position where this B stock is guaranteed so the Spokane bank can be a stronger entity and maybe hang on to the rest of the borrowers, and perhaps in the years to come entice some of these borrowers that dropped off back into the Farm Credit System; is that correct?

Mr. OLSON. We're not pressing for legislation to guarantee this stock.

Senator MELCHER. Then we'll drop the legislation, coerce, convince or sugar daddy them somehow into agreeing to pick up that $16 million so that the four PCA's in this district will either B stock guarantee those under liquidation, those four that are under liquidation.

Mr. HASLEBACHER. Mr. Chairman, I think everybody in this room, lender, borrower, Congressman alike can safely say their druthers would be to have the B stock made good. The problem is who's going to pay for it. We have a weakened FICB whose financial viability is threatened and other banks from the districts that are putting up capital to assist us have their own problems to look at as well as ours. When they look at the assistance program, it doesn't seem to them to be a prudent business risk to make somebody else's risk capital good. So it's a problem of who is going to pay for it. Does the Federal Government want to pay for it? We have to look at the source of funding.

Senator MELCHER. Well, I assume what would pay for it would be the ability to sell this paper on the money market. The higher the

interest costs, the worst position it puts all the Farm Credit System in; isn't that correct?

Mr. HASLEBACHER. This is one of our concerns, that all the adverse publicity will increase the cost of bonds. But this is a two-edged sword in that the FICB rate, already, in 1984 was higher because of nonperforming loans. It had 100 percent of its portfolio that it was paying interest on while receiving interest income from less than 90 percent of its borrowers. So if we simply borrow money on the money market to make the B stock good, we have more interest to pay on this side, and the interest rate to the borrower has to go up further to the remaining borrowers.

Senator MELCHER. Today, April 8th.

Mr. HASLEBACHER. Correct.

Senator MELCHER. So we're talking about what happens after this morning of April 8th. If the Spokane Intermediate Credit Bank is going to continue to lose their better borrowers, 16 percent of whom have already dropped off, action must be taken that not jeopardize the sale of all of the paper for the entire System.

Mr. HASLEBACHER. The demise of the FICB of Spokane would have shock-wave effects on the bond market; this is correct. We do believe though, Senator, that this district consolidation plan that has been worked on by directors and management will maximize our risk taking ability so that we can improve our interest rates and stabilize our customer base.

Senator MELCHER. Mr. Olson, you lost 16 percent. What if you lose another 10 percent and so you end up in 1985 with a 26 percent loss of your borrowers. And assuming the trend will continue, these lost borrowers will be the more credit worthy borrowers. What is the loss going to do to the Federal Intermediate Credit Bank in Spokane?

Mr. OLSON. We have programmed into our scenarios that we still have viability with some additional drop in volume. One of the things that we have accomplished, as Mr. Hasleбacher mentioned, is with the program of financial assistance from the other banks, we have presently been able to reduce the direct loan rate to PCA's from the credit bank by a half of 1 percent. This is because we could use this $25 million interim assistance to cover our operating losses until such time as we get the full package put together.

Basically what our charge is, is to get the consolidation into place, use the marketplace, use the assistance money of removing of the high risk paper into the other banks of the Nation's portfolio, so that we return this district back to a position of viability. This is the point when we can start looking at our interest rates being on a competitive basis in the marketplace, and, I think this is the beginning of rebuilding the 12th district into a strong, viable institution. I think this is what we're all after. This is what protects the B stock and the borrower source of credit.

Senator MELCHER. Are you saying that you expect 1985 to be a profitable year for the bank at Spokane?

Mr. OLSON. No.

Senator MELCHER. So it's a question of how much it's going to lose. What loss do you project?

Mr. OLSON. We are estimating at the present time $15 million in losses this year.

Senator MELCHER. On that basis, I'm going to return to the same question, Al. Is that fair, Mr. Olson?

Mr. OLSON. Yes.

Senator MELCHER. If it doesn't get worse, $15 million and then there would be an additional $25 million, would it not, or how are you counting that $25 million?

Mr. OLSON. It will not take all of the $25 million. We've used approximately $1 million of the $25 million to cover our operating losses to date. We expect to have the full program in place by May 31, so that we probably will be drawing less than $2 to $3 million of that first $25 million. We will substitute that with the full program which, again, is the sale of our high risk paper into the other banks.

Senator MELCHER. From this date on, would it not be better business for the Farm Credit System to guarantee the B stocks, as a sell for the entire System, to improve the acceptability of the paper on the financial markets?

Mr. HASLEBACHER. Up to this point, the bond market has not reflected the adversity affecting the Farm Credit System. At some point, it's obviously going to pick up on the distress on agriculture in the Farm Credit Banks, and anything that can be done to add confidence to the bond market dealers, obviously, will be positive.

Senator MELCHER. From last December up until this date in April, how many times have you sold bonds and into what volume?

Mr. HASELBACHER. Well, the sales occur each month and, Rod, you're closer to the bond sales than I am.

Mr. OLSON. Well, that varies each month. Currently the credit bank has not been drawing much money in this district because our volume is fairly stable.

Senator MELCHER. The bonds are all sold in New York, are they not?

Mr. OLSON. Yes.

Senator MELCHER. When was the last significant sale?

Mr. OLSON. The first of this month.

Senator MELCHER. How significant was it?

Mr. OLSON. Very small amount to the credit bank. The land bank took a——

Senator MELCHER. All right. When was the last large sale made?

Mr. OLSON. That we took a—there's a large sale each month, Senator, and the various banks of the Nation take—each one takes a share of that particular sale.

Senator MELCHER. Well, what's your total sale per year?

Mr. HASELBACHER. We have $83 billion in outstanding bonds, and we have an average portfolio life of about 4.3 years in FLB and a little over 1 year in the other banking systems. So there is a turnover——

Mr. OLSON. Probably $30 billion.

Mr. HASELBACHER. $30 billion.

Senator MELCHER. How much has been sold, so far in this calendar year, of that $30 billion?

Mr. OLSON. Probably a fourth of it at this point.

Senator MELCHER. My understanding is that the sale made in March was a very small sale. The regular customers that continually turn over in their portfolio the same bonds from the Farm

Credit System just went in there, bought them at a fairly good rate of interest. What happen on April 1st. Do you know yet?

Mr. OLSON. There has been no indication from the marketplace yet that there has been any reduction—or any increase in our bond rates because of our problems.

Senator MELCHER. I hope that continues. But all it's allowed you to do is put out money at just under 14 percent, which is rather high. The interest rate is not especially attractive, particularly if you've got to feel that your B stock as a borrower may be at risk. It doesn't put you in even a viable position.

Mr. HASLEBACHER. We are somewhat closer to being competitive than we were several months ago, Senator, not that we feel that we're competitive yet. Our rate was 1 to 2 percent higher than commercial banks and today we're down at a half to 1 plus percent. I talked to a lady on the phone just last week from the Glendive PCA who had paid off her PCA loan and refinanced with a commercial bank at 13½. And I just noted in discussion with her that the Conrad PCA was charging 12½. With that half percent reduction and with stock they were at about 13¼. So in some areas we're getting close to being competitive.

Senator MELCHER. Yes, I think you are competitive at Conrad, but that's one out of eleven, one out of eight, if we exclude the three that are in liquidation.

But I'm hopeful that you can be competitive, and very soon. But without guaranteeing B stock in these liquidated PCA's, I think you're treading a very thin line.

Mr. Olson, has the initial reaction to throwing everything into one huge PCA been adverse?

Mr. OLSON. There was adverse reaction to it until the full program could be thought through and explored, and we've been getting very good reaction, recently. We've got a very strong, I think, affirmation of the program by most of our associations.

Senator MELCHER. Well, I will be talking to farmers and ranchers to see what can be done. I hope you don't have yourself locked in concrete on a particular position.

Mr. OLSON. No. Of course it's a stockholder/member vote that will ultimately determine whether we have mergers or not.

Senator MELCHER. Tell me more about the election of the directors. Would there be a director from each of the PCA's elected?

Mr. OLSON. Basically, we're proposing a plan, one PCA for the district, and then there would be approximately 35 to 40 service centers scattered throughout the four Northwest States. Each one of those service centers would have a local associate board of directors with delegated authorities. That delegation would come from the one PCA or one FLBA.

Senator MELCHER. Would their votes be equal?

Mr. OLSON. Votes of which? From the service center?

Senator MELCHER. Yes, each service center.

Mr. OLSON. Each service center would be equal.

Senator MELCHER. Would Kalispell be a service center? Is that what's depicted as a service center?

Mr. OLSON. We have not determined the final location of each service center. Kalispell could possibly be a center or a branch of the Missoula office.

Senator MELCHER. Well, if it were a branch, then there would be just one vote for the Missoula/Kalispell combination; is that correct?

Mr. OLSON. Yes, or one board of directors for the combination.

Senator MELCHER. But one member of the board of directors.

Mr. OLSON. And each board member would have an equal vote in that service center.

Senator MELCHER. When would this be determined?

Mr. OLSON. The plan is under—in the writing stages right now. We're planning to go to association boards in this coming month to go further into the program and to take a look at bylaw amendments so that it can be affected. We would be looking at June and July for stockholder meetings to vote on the merger.

Senator MELCHER. June and July?

Mr. OLSON. Yes.

Senator MELCHER. Well, I think it's fairly significant to have the confidence and the feeling of managing their own cooperative in each area. When this PCA voluntarily liquidated, there wasn't much volunteering about it. That's the only option available. I'm just cautioning you to try to listen to the farmers and ranchers now, before you get too far into this process. That will be an election process, will it not?

Mr. OLSON. Yes. We are currently working with all of the association boards of directors in the district. These are elected representatives of the stockholders, and so we are attempting to get all of the information we can to the local association. We'll be sending our full disclosure of all of our plans to each individual member.

Senator MELCHER. All right. Thank you all very much, all of you.

Mr. HASLEBACHER. Thank you, Mr. Chairman.

Senator MELCHER. Our next panel and last panel is John Lawyer from Plains, Robert Deschamps, Jr., from Polson, Jack Rupe from Moiese, and Mike Roth from Vancouver, Washington, from Western Washington PCA.

Senator MELCHER. Who will be testifying first?

STATEMENT OF JACK H. RUPE, REPRESENTING WESTERN MONTANA PCA STOCKHOLDERS COMMITTEE

Mr. RUPE. My is Jack Rupe. I'm from Moiese, Montana, and on behalf of the Western Montana PCA Stockholders Committee, I hereby convey to you, Senator, our appreciation for coming to Missoula and giving us this opportunity to present the borrowers' view of the so-called farm credit crisis that is impacting our local production credit associations. I am certain that in this regard I also speak for other PCA's of the 12th District of the Farm Credit System.

As you know, and has been said many times already this morning, four PCA's in the 12th District are currently being liquidated by the Federal Intermediate Credit Bank of Spokane, the so-called FICB, in a series of actions that we, a large faction of the stockholders of these PCA's, believe to be unlawful. "All of these PCA's are being liquidated in an iron handed ruthless manner in complete disregard for the fundamental purpose for which the PCA was created."[1] The FICB has unilaterally and arbitrarily deprived

us of our corporate leadership, our rightful role in evaluating and in disposing of our corporate assets and, without proper authority, "frozen" our associations' B stock.

We, therefore, have embarked on the only course of action available to us, litigation in the courts. Each of the four PCA's in liquidation, Western Washington, Western, Montana, Milk River, and Glendive have formed stockholder organizations representing their individual areas and have pooled their efforts and assets in order to bring two separate complaints to the courts. The first of these is "—a class action, seeking class certification as a national class seeking injunctive relief restraining further liquidations of any further PCA's or forclosures on PCA's until the FCA complied with the mandate of Title 12 U.S. Code Section 2183, by promulgating acceptable regulations after notice and hearing."[1]

This suit was filed the 21st of February, 1985 in the United States District Court for the District of Oregon as docket number 85-219. A 30-day moratorium against foreclosures was issued the 4th of April, 1985.

A second complaint, which is currently being drafted, will be used as the basis for negotiation with the FICB in an effort to obtain an out-of-court settlement. If such negotiations fail, a formal complaint will be filed. This complaint will be in the form of a class action suit seeking a judgment that would require that the FICB and PCA comply with its commitment to retire their B stock as loans are paid off. Said retirement would be retroactive to the date the FICB ceased to honor this commitment. We believe, based on a preliminary evaluation by counsel, that the FICB may be guilty of misrepresentation due to its failure to disclose to B stock purchasers the true financial condition of the bank at the time of stock issuance.

Although the legality of the bank's action in freezing the B stock is suspect,[2] it is difficult to imagine any action that the bank could take that would be more detrimental to the borrower. Or, for that matter, to the bank itself. Every category of loan is impacted. The liquidation rules are such that all of the better loans are forced out of the System, leaving the nonperforming loans and loans under foreclosure to support a bank that is already losing $800,000 a month.

The maximum stress is probably imposed on those borrowers who are highly leveraged but who, during some pretty tough times, have been making both principal and interest payments on time. Admittedly, there is little left at the end of the year to apply to equity, but at least they were not going backwards. Now, the bank steps in and extracts for its own purposes 10 percent of the borrower's equities. It further says that if said borrowers want to transfer to another PCA, he must invest another 8 to 10 percent of new money in the purchase of additional B stock which is, for all practical purposes, already impaired. Further, if the borrower attempts to refinance with another bank, he must purchase the worthless B

---

[1] Cf ref. p.4.

[2] The banks sole authority for this action is (apparently) a "directive" from its supervising agency. No such authority is explicitly contained in 12 CFR 611.1130 (Cf R of A) and the FCA has failed to promulgate and obtain approval of such rules. (Cf FR VOL 50 No. 30/Wednesday, February 13, 1985 pp. 6000-).

stock before the PCA will release any lien or mortgage, regardless of the equity the borrower might have at that time.

In order to provide some relief for those borrowers who transfer to another PCA, the bank is offering an interest-free loan to recover the cost of the B stock issued by the liquidating PCA. If the bank can make interest-free loans, why not redeem B stock? The answer is apparently contained in a statement made by Tom Brown in January of this year, and I quote him as he says, "Quite frankly, the bank is not in a position to make an interest-free loan to anybody. We've already made $286 million worth. We don't have any more room". Obviously, this is a ridiculous ploy which simply sets the stage for the bank to extract two sets of B stock purchases from the same borrower.

For those borrowers who are able to find financing elsewhere, namely at a commerical bank, they must somehow find new equities to support their loan to purchase that same worthless B stock. This is not an easy task for most borrowers. And, of course, the real pain is in giving a substantial portion of some $16 million in B stock held by the four PCA's in liquidation to a System that overall earned a profit of $400 million in 1984.

For those borrowers whose loans were truly in the vulnerable class, this 10 percent loss in equity immediately pushes them over the brink into foreclosure. And, of course, the ironic thing that happens then is that the bank then proceeds to redeem the B stock associated with those loans since they become a part of massive writeoffs or charge downs that are being financed by the assets of the remaining stockholders. This is a snowball that seems to end only when the bank itself finally goes into liquidation. And according to Larry Butterfield:

> The one thing that is preventing that is the impact that that act would have on the bond market. . . .

According to Butterfield:

> . . . Pete Carney, the president of our funding corporation, estimates that it would increase our cost of bonds by one to one and a half percentage points. That equates to somewhere between $500 million and $700 million additional in costs per year, every year, for a long time.

Under these circumstances, it would seem that the FCA and the FICB in particular would be doing everything in their power to retain member confidence and bank credibility. And it seems to us that an absolute first step in this direction is to honor its commitment for automatic retirement of B stock, A stock and payment of stockholder owned allocated surplus. Certainly the relative costs would be miniscule.

Contrary to the rational approach as suggested above, the bank takes the position that there is no obligation to redeem the B stock since it is considered risk capital, for whatever that means. I assure you that there is no one that understands risk better than the farmer/rancher. There's risk in everything he does. A rancher buys a cow, with or without the help of the bank, and the risk is all his. If the cow dies, he's stuck for the entire bill, and he knows it. A farmer buys an acre of ground and plants it to grain, and he knows that if land depreciates his equity is at risk, as well as his note. He knows that if the tractor blows up, the hired hand gets

hurt, or if grasshoppers, drought, fire or hail destory his crop, the risk is all his. If his costs are more than the crop brings in, even if he hasn't paid himself a dime, the risk is all his, and he knows it. But, when a bank sells stock in its organization as a condition for making a loan, and fails to disclose the fact that the bank is not financially able to retire that stock at the value paid, then there's something more to that transaction than just "risk." At best, such actions represent a breach of fiduciary responsibility which can only be resolved by forcing the bank to live up to its commitment to redeem its B stock.

It is therefore requested that the Senate Agriculture Committee take such action as is appropriate to assure that the FCA and the FICB of Spokane will comply with the following conditions:

One, members of PCA's who transfer their loans to the Bozeman PCA (or any other cognizant association) will have the proceeds for their PCA B stock redemption credited at par value or against their B stock investment requirement in the new association. Any net difference will be retired at par value.

Two, B stock redemption credits on PCA paid off loans will be paid to members at par value.

Three, Class A stock of PCA's will be retired at par value.

Four, all other member B stock participation certificates and allocated reserves will be processed at par value.

Your assistance in this matter will be deeply appreciated.

Senator MELCHER. Bob, are you next?

STATEMENT OF ROBERT DESCHAMPS, JR., POLSON, MT

Mr. DESCHAMPS. All right. Thank you, Senator, I, too, appreciate you're coming out here and listening to our tale of woe. I'll be as brief as possible. We need a Farm Credit System to prevent the deterioration of rural business, to create competitions, to keep interest levels down, and to prevent monopoly by local banks and to give the borrowers and stockholders some control

However, the Farm Credit System needs to be restructured to its original intent and to operate as a true co-op. And first we should repeal the farm credit provision of 1971; second, put loan control in the hands and the direction of the local loan boards; and third, get the stockholders' approval of any capital expenditure for fixed assets. We feel we've got too many mausoleums to management that we can ill afford to pay for in the fantastic buildings that have been put up in the last few years. Fourth, a system nationally, regionally and locally to be audited by independent auditors, not by in-house juggling that's not answerable to anycne but themselves. Fifth, to set up money management committees locally to advise and suggest solutions for local problem loans.

If the Farm Credit System properly managed and utilized its available resources, all built up from the earnings or investment of farmers, much of the current farm credit crisis would be alleviated or averted. The PCA's high interest rates and liquidations are partly the result of structural flaws in the Farm Credit System. They should establish a centralized cash reserve for rescuing member banks in financial trouble, and establish a ceiling on the amount of outstanding loans held by individual borrowers. And there's an excerpt from a representative Cooper Evans from Iowa, and I would like to add this in here. He has got a bill in to require

the land banks to offer farmers the option of a fixed rate, 20-year mortgage instead of this variable that can wipe them out in a very short time.

The liquidation process used by the Western Montana Production Credit Association has further deteriorated the equity status of borrowers and stockholders by not doing what we were told would take place by Tom Brown, Sr., vice president of the FICB in the 12th District in January of 1985. At which time he told us to liquidate the PCA's would be in an orderly and expedient manner, that they would maintain continuity until the liquidation was complete. To date, the borrowers are not sure what continuity means. We don't know whether we're going to be financed, refinanced, or foreclosed on or thrown down the drain. To maximize return association assets and minimum losses to its creditors and to focus on the collection of problem loans, he told us there would be no fire sale, there would be no blood bath in the liquidating process. It could take up to 5 years. He also told us that they would transfer loans to other PCA's or commercial banks at competitive interest rates, much of which has not been done. I, to my knowledge, to this date, have not seen one liquidating officer help any borrower secure any commercial bank loans. And if we transfer to the Bozeman PCA under the present status, you're automatically in debt another 8 percent before you ever start to pay it back. With our present financial structure and stress in agriculture today, we don't need to have the banks throw an additional 8 percent loan or capital cost onto us. We've got enough problems.

We don't need more of the same from the management bent on saving their jobs at the expense of the borrowers. Their flaunting a super PCA only takes more control from the locals and the stockholders and puts more power in the hands of bureaucracy. Any commercial bank being reorganized first has all its officers removed and new management installed. Eight pages of rhetoric in a paid add in a national magazine, the Current Farm Journal, which solves no problems but whitewashes the Farm Credit System and magement, only strengthens our argument for a change. We need PCA small. We don't need super PCA's. For 50 some years the Western Montana PCA existed as a viable form of credit for western Montana's agriculture. It started our in 1933 with my father, Mr. Bill Cruse, a Carol Nelson and a Mable Terry, and that was the total PCA group. They covered 19 western counties and they bailed out a awful lot of people who were having severe financial problems in those days, and they ran a good, farm-oriented farm-lending organization. I think it's high time we get back to financing agriculture by agriculturalists and saving this system as we need it. Thank you.

Senator MELCHER. John, are you next?

Mr LAWYER. Yes.

Senator MELCHER. You have a lengthly statement. Rest assured that all of it will be part of the record.

Mr. LAWYER. I'm not going to read it all.

Senator MELCHER. I don't know how you can read it all, but I urge you to summarize the statement.

STATEMENT OF JOHN N. LAWYER, PLAINS, MT

Mr. LAWYER. Senator, I'm going to speak from some notes.[1] I'm going to try to emphasize those things that have been left out thus far today, and only very briefly touch on points in my paper that pertain to those things that you have mentioned or that members who have given testimony here have mentioned.

First off, I'd like to say that my knowledge and awareness of details of the Farm Credit System has only been developed in the last 3 or 4 months. We have been a member of the Western Montana PCA for over 10 years, and it was the B stock crisis that really motivated myself and others to get well educated on the problems, in western Montana, within the 12th Farm Credit District, and on a national level. To do that I personally have talked to over 200 people nationwide. These have been farmers, management people in the farm credit banks, as well as former board directors and so on.

Now, I think the picture is far more serious and far more severe than what the Farm Credit Administration is leading us to believe. Given the recent comments of the senior management of the FICB in Spokane, and this is confirmed here today, they're essentially broke. Also, it is highly questionable whether or not the other banks in the Farm Credit System can or will provide enough financial support to the bank in Spokane to salvage it as a viable entity. In speaking to people around the country, there is every indication that farm credit districts elsewhere are under a similar high level of financial stress, due primarily to the overall stress in agriculture, but at the same time from past policies of liberal lending and poor management.

The paradox in this situation is that the bonds that support the entire Farm Credit System continue to sell, as though the System is financially sound. The management of the Federal Farm Credit Banks Funding Corporation, as well as the Governor of the Farm Credit Administration pronounce the System to be financially sound and very solvent.

Now, someone isn't telling the truth. We think it's crumbling from the botton and we need to know what the true financial strength of the Farm Credit System is. This is impossible to determine from the information that the Farm Credit System is putting forward, either to the stockholders or we would suspect to Congress. They audit themselves, they review themselves. There is no outside, external watchdog that is looking at the financial details of the Farm Credit System at any point or is giving this information to the stockholders or to the public.

I believe that the entire Farm Credit System is in substantial trouble. I had a conversation recently, actually it was yesterday, with Dr. Neal Harl, the professor of agricultural economics at Iowa State University, and he confirmed that 10 of the 12 districts are under severe stress. In fact, he named specifically which ones he feels will follow the Spokane banks down the tube. Those are—I may not have them in correct order, but Omaha, Louisville, Witchita and then others.

---

[1] See p. 44 for the prepared statement of Mr. Lawyer.

It would seem to us the Congress has to dig into this a lot deeper than simply the B stock issue, although that's certainly our priority here. We would ask the question how is this only a $4½ million problem, namely the B stock? To Congress, I think to you Senator Melcher, to the American people and even to the President of the United States, this may well be an $80 or $90 billion problem.

Now, I'd like to digress for just a moment and present to this hearing a copy of a transcript of the district status meeting of the Federal Intermediate Credit Bank that was held in Spokane, Washington January 3rd and 4th, 1985. This is an imposing document. Several of us have read it more than once, and we have digested most of it, but we have not—we have not had the time, really, to summarize it in a more concise form other than my comments. I do have some notes in the front of your copy for you.

Now, this district status meeting was attended apparently by about 50 to 60 people, primarily PCA presidents. It was chaired and run by the FICB management in Spokane. I think the transcript clearly shows that there is absolute chaos in management, both in Spokane and possibly elsewhere. Throughout this transcript the sum and substance of it seems to be that they are saying:

> Well, boys, we've got a problem and we just aren't sure what to do. We've tried several things, but they haven't worked. We've gone to the Farm Credit Administration and they haven't helped us either, and we just don't know what we're going to do.

Now, I ask how can an $80 or $90 billion financial institution be run with that type of management? The mere fact that such a meeting would take place clearly illustrates the lack of management and the serious crisis in management that we see within the Farm Credit System.

Elsewhere in the transcript bank officials admit, and this was before it came out in public, that the FICB is broke. They admit that they lack solutions to problems. They admit that the PCA's in liquidation were under severe stress, and they recognized this stress long before they were closed and the B stock was frozen. They also enumerate other PCA's which are likely to close because they're under such severe stress in the 12th district. I would point out that senior bank management has emphasized that Central Montana, Western Idaho, Northern Washington and other PCA's may well be on the verge of collapse.

They (bank management) also recognize, as Jack Rupe has pointed out, the consequences of an FICB collapse on the bond market. Now, we believe that the reason that this thing is being propped up artifically is that if the FICB in Spokane collapses, it will bring undue stress on the bond market and that will bring the whole thing down. Bank management is quoted in the transcript the numbers are a little bit different, than what Jack mentioned—that the collapse of the Spokane FICB could cost the System an additional $500 to $700 billion in annual interest costs. I would pose the question how can competent management risk an $80 billion Farm Credit System for $13 million in B stock? $13 million in frozen B stock, How can they risk, increasing the interest costs by $500 million for $13 million in B stock? It just doesn't make sense.

We think these management problems persist all the way up through the Farm Credit Administration. The System is terribly

inbred. There's been very little outside, external competent corporate type management brought into the System over the years.

I've had the opportunity, to read some transcripts of court depositions that review the background of some of the officers in Spokane. I have these and will submit them to this hearing. Although I don't wish to question them personally, I think the depositions illustrate their lack of outside experience. We would suggest that that is a lot of the problem. These people are not qualified to undertake the reorganization that is necessary.

The management problems persist all the way down to the local PCA level. Most of the local loan officers are brought in fresh out of school. They're not exposed to the type of training that would make them question credit management the way that commercial banks would do. Farm credit bank managers have been promoted up through the System. This means that these people, lacking commercial experience, are now largely those who sit at the district bank level.

The Farm Credit System overall is in need of a major congressional investigation. We feel that it's in order, that it's absolutely essential, and must take place in the very near future. We would like Congress to determine the true financial strength of the System. We don't think that without external audits that it's financial strength has been established. We also would ask Congress to undertake the redemption of our B stock. Both within the Western Montana PCA and elsewhere. We feel that in order to secure the confidence of the borrower that the B stock must be guaranteed on a nationwide basis, and also to maintain the System, that the bonds be guaranteed. Because I think once the bond dealers and the bond buyers begin to understand what's going on down here at the bottom, they're going to become very very concerned.

We understand that funds do exist in the so-called revolving fund set aside by the Congress, and that these could be accessed by the Governor of the Farm Credit Administration for such things as redemption of B stock. It is our opinion that the reason that this is not happening is that by activating the revolving fund it subjects the Farm Credit Administration to some further secrutiny by the Government. I don't know all the details of this, but we're told repeatedly that these funds are available, if they will use them.

I'd also comment on some of the proposed solutions which have been brought forward. I think that the "Super PCAs" are not a legitimate cooperative structure. I would point out that more concentrated management, will increase the takeover of the System by the bureaucracy and that it also will increase the vulnerability of the System to mismanagement. The more monolithic the structure is, the more concentrated the management is, and the larger the chance of having mismanagement becomes. We believe that the real key to success of the Farm Credit System over the years was the very diversified management throughout the local PCA's.

Finally, we have carefully reviewed the Farm Credit Administration's proposed regulations published in the Federal Register on February 13, 1985 and that were commented on both by the officials of the FCA here this morning and others. We urge you and the Senate Committee to keep these regulations from being adopted until such time as they can have public scrutiny, public review,

public hearings, and until Congress determines fully whether or not they meet their intent of the law. The proposed regulations, we believe, fail to provide representation by the stockholders during liquidation. They fail to provide due process to individual stockholders that may be in the throes of personal liquidation. They have no appeal procedures provided for in them, either by the stockholders with respect to their local PCA or by stockholders' rights with respect to their own loans. So we would urge you, as a final point here, to keep these regulations from being adopted until they've had a chance to be thoroughly examined and reviewed both by Congress and by the PCA stockholders. Thank you.

Senator MELCHER. Mike Roth from Vancouver.

STATEMENT OF MIKE ROTH, VANCOUVER, WA

Mr. ROTH. I appreciate being asked to be here today. My name is Mike Roth, and I'm a third generation farmer from Vancouver, Washington. And I would simply like to tell what happened to our production credit association. Our association is located halfway between Portland and Seattle, about a hundred miles inland from the coast. It's very diversified farming.

I'm a resigned director of the Western Washington Production Credit Association. On December 19th, 1984, the Federal Intermediate Credit Bank of Spokane took action to stop the automatic retirement of member capital stock or class B stock in our PCA.

It's my perception that the collapse of the fishing industry, lumber industry, the depressed agricultural economy, and factors directly relating to the FICB and FCA managements led to the eventual decision to place Western Washington PCA into voluntary liquidation. According to the FICB and FCA audits, our association was deemed to be nonviable, after 50 years of creditworthy service to the farmers, ranchers, and fishermen of western Washington. In 1982 the FICB congratulated our association for 50 years of hard work.

Now, because of 2 years of trouble in our association, the bank's management in Spokane and the FCA have recommended to the board of directors of Western Washington PCA that based on all the pertinent facts, liquidation of Western Washington PCA is the only alternative.

It was also decided that it is in the best interest of Western Washington PCA to have its territory serviced by Central Washington PCA which is 200 miles away and across the Cascade Mountains of Washington. The two geographically different areas have very little in common in terms of agricultural commodities.

We, the board, were told by the FICB management that if we did not voluntarily liquidate the association and resign from the board, they would do it for us. We were told that people from the FCA were at the airport in Washington, D.C. ready to board an airplane to come and liquidate us and "close the vault," is the term the FICB management used. And that is the truth. We were told that if we did not voluntarily liquidate we would not want to be around to witness the heavy handedness of an FCA liquidation. Little did our board realize how important it was for the FICB to convince us to voluntarily liquidate our association.

I believe the FICB was in the midst of attempting to have FCA release assets of the Willamette Production Credit Association which involuntarily went into liquidation and was being liquidated by the FCA. If the FICB, because of their newly acquired experience in the liquidation process could convince our board to voluntarily liquidate, they could then appoint an FICB liquidator and liquidate the association uninterrupted by the FCA. By liquidating our association, the FICB realized an infusion of capital from members disenchanted with the Farm Credit System and were creditworthy enough to find alternative financing in the commercial banking system. The FICB would then receive payoffs, thus increasing their viability instead of having to activiate their districtwide mutual loss-sharing program which is designed to save associations in times of trouble. And I'd like to say that just the word mutual goes back to what we were talking about in cooperative association.

When Willamette, Southern Idaho, and Puget Sound PCA's were liquidated, I was on the board. And we read the newspaper and we follow what happens, especially if you're a director. When you read that these associations are being liquidated but the bank is stepping in and making credit available and guaranteeing the B stock, it definitely gives you a false sense of security. Because we, as board directors, did not go out and alarm our members. We maintained our integrity. We tried to oblige the bank in Spokane. But to see other B stock made good gave credibility to the bank in Spokane.

The FICB would then have complete control of Western Washington PCA's assets with no local supervision. We were supposed to receive timely reports. I haven't received one thing, and it's been over 3 months. The FICB would then not only have our assets in 4.2 million farmers' B stock, they would have an association in need of help off their backs. I hardly believe that the founding fathers of the Farm Credit System had this sort of manipulation in mind when the System was founded.

In the summer of 1983, the newly elected president of the FICB in Spokane called an emergency meeting or our board. He informed our board that because of the liquidation of the Puget Sound PCA, our association was being asked to serve the Puget Sound territory. If we said no, the Governor of the FCA, by law, has the authority to make us serve the area. The FICB president told us point blank that the FICB would not and could not allow another PCA to go broke on the coast. He said that more than once. He assured us that FICB would do whatever it takes to keep our association solvent. With the assurances, promises and professional ethics in our minds, our board decided to oblige the FICB request and serve in the new territory. Approximately 1 year later, we were being told by the same bank president that our only alternative was to liquidate our association.

The fact of the matter is this. I believe the Farm Credit System has failed us. The farmers and ranchers who depend on the money to operate our farms and live our lives with pride and dignity. Liquidating our farms and manipulating us like cattle in a stock yard and suppressing our eternal hope is like turning a wonderful dream into a nightmare. I certainly hope my testimony reaches the

ears of someone who will simply say we're ready to help. Thank you, Mike Roth.

Senator MELCHER. Thank you, Mike. The two letters by David Lawyer and Esther Lawyer will be made part of the record. The demands made by the Western Montana PCA Stockholders Committee will also be made part of the record.[1]

The hearing record will remain open until 15 days from now. Anyone wishing to submit additional testimony, please do. You do so by preparing it in typewritten form and sending it to me in Washington. I'll make sure that the statements become part of this record.

I want to say to all four of you that your testimony is right on target. This is the type of testimony that we must have for the Senate Agriculture Committee if we're going to make some sort of judgment. It's "grass roots," it's direct, it gets at the basic problem, and it reflects the judgments of the PCA borrowers.

If we're going to help determine, as a committee, what will be the future for the Farm Credit System, we have to understand what the situation is, and how bad it is, right now.

Your testimony is very significant, in my judgment. If we in Congress are going to make any kind of judgments for the future on what happens to the Farm Credit System, we have to understand right where we are.

I might relate to you, my experience with the Farm Credit System over 16 years in both the House and the Senate has been one that has been entirely favorable. I think, Bob, you say we ought to start by modifying the act of 1971; is that correct?

Mr. DESCHAMPS. Yes.

Senator MELCHER. I think perhaps I'm typical of people serving on either, the House or the Senate Agriculture Committee. Up until now, we have been of the opinion that the Farm Credit System was operating in a manner that met the test, first of all, of performing in a way that satisfied the public interest. Secondly, we believed the System was performing in such a way that it satisfied the needs of credit for agricultural borrowers. The events of the past year or two have caused some of us to realize that the System isn't in that good a position, the needs of farmers and ranchers are not being adequately met, and that perhaps the System itself is in jeopardy. Did you have something you wanted to say here, John?

Mr. LAWYER. I might comment on what's transpired since 1971, because we've looked at that in quite some detail. There has been a gradual process, since 1971, of the System being taken over by the bureaucracy. Now, there are people that believe that this is a conspiratorial action. I don't. I think it's just a natural evolution of a large bureaucracy. This has shown up by the erosion of control by the local boards and the various other boards. I think this was a large part of the motivation for the liberal lending in the 1970's, the image building of big buildings, the advertisements like Bob Deschamp, has rerferred to, and so on. The System has been taken over by the bureaucracy. It's now outside of the hands of the farmers and the stockholders.

---

[1] See pp. 55–57 for the letters from David and Esther Lawyer and p. 57 for the demands from the Western Montana PCA.

Senator MELCHER. I think a very basic point, and one that Congress must address, is whether or not the control of the Farm Credit System is actually under local control. I'll try to do what I can to determine how this has contributed to the situation we're in now.

I have a little bit of problem, in comprehending how the proposed procedure will be, first of all, an adequate way for a cooperative to run its business and, secondly, whether or not judgments that are made are truly representative of the prudent judgments that should be made by individual borrowers running their own affairs through their own cooperative.

We need to work for retention of the Farm Credit System in a viable form, in a form that is progressing, in a form that is not losing its membership but attracting membership, in a form that is truly competitive with commercial banks and, therefore, providing the bulk of the credit that is necessary for American agriculture. That's what it's for. And that purpose is not going to change.

Congress must assess properly where we're at at this point in time, and to make necessary adjustments to make sure that we continue to and do have the opportunity for agricultural borrowers to get the necessary credit at reasonable rates of interest.

The rates of interest that are now being paid both by PCA borrowers is to high—even including that one in Conrad, which I think is the lowest of all in Montana, perhaps all in this district of the PCA's. If it's too high for PCA borrowers, it's too high for commerical borrowers. What we must do is maintain the viability of a Farm Credit System, through its PAC's to do what it was initially set up to do, to provide competition to the commercial banks. That competition just does not exist now.

Lack of competition is one of the reasons, I believe, why interest rates are so high for all agricultural borrowers at this particular time. It doesn't do us much good to be reading about a prime rate that went down to 10½ percent or wherever it's at right now, and is not available for agricultural borrowers. The best rates of interest that are possible in this country, should be provided for agricultural borrowers. The best rate of interest should be available for borrowers in our most basic industry and I'll attempt in every way to do what I can to assist in that process.

As to the regulations that you mentioned, John, we will give them particular scrutiny, and I'm glad you made that point.

Mr. LAWYER. There's one other thing I forgot to mention that I'd like to bring up, if I may very briefly. The Farm Credit System has proposed to form the Agricultural Conservation Corporation. Are you familiar with that proposal?

Senator MELCHER. No, I'm not.

Mr. LAWYER. The Farm Credit Council, which is part of the Farm Credit System, is proposing to buy up between 16 and 20 million acres of American farm land to take it out of production, and that the Agricultural Conservation Corporation (ACC) would own and manage this land. It would remain out of production, and in the hands of the Agricultural Conservation Corporation until such time as it achieved certain improvements in agricultural value. Now, we view this as absolutely unacceptable. Once those land holdings were put together, they would never be taken apart. It

would effectively make the Farm Credit System one of the largest private land holding entities in the United States. They're proposing to buy machinery, to hire managers and to farm it.

Senator MELCHER. Well, maybe that's the reason I haven't heard of it. It sounds so fuzzy, it isn't going to get anywhere.

Mr. LAWYER. This was presented to the House Agriculture Subcommittee on Conservation Credit and Rural Development on February 7, 1985.

Senator MELCHER. Well, it may already have been properly buried there in that subcommittee. We're not in the business at this time of trying to create a new entity of soil banking.

Price for products is still the key point. I'm not forgetting that. The agricultural prices must come up for the entire agricultural industry. It's on that note that I'm going to conclude this hearing, because we're going very soon into a discussion of the pending farm bill. The farm bill has an awful lot of things in it. For those of you who are interested in that subject I will be responding to any questions you have concerning it later.

This meeting of the Senate Agriculture Committee is now adjourned.

[Whereupon, at 12:50 p.m., the committee adjourned, subject to call of the Chair.]

APPENDIX

U.S. SENATE,
Washington, DC, April 5, 1985.

Hon. JOHN MELCHER,
U.S. Senate, Washington, DC.

DEAR JOHN: Thank you for persistent efforts to convince the Senate Agriculture Committee to sponsor hearings in Montana to investigate the liquidation of the Missoula, Glendive and Chinook PCAs. I wish I could have joined you for these important hearings.

I know the Montana PCA members recognize your efforts to provide Montana's farmers and ranchers with credit and financial assistance only to be turned back by Presidential veto, inaction, and lack of concern for U.S. agriculture and rural America.

I pledge my full support and cooperation in your efforts to help PCA members who, through no fault of their own, now face difficulties finding credit to finance their operations.

I recognize that the liquidation of the PCAs is only a symptom of the larger financial problems that face agriculture. I believe we must respond in the short run to help keep PCA members operating. We also must act on longer term agricultural policy to improve farm income and hold down production costs, particularly interest rates.

Once again, thank you for holding hearings on this critical issue. I stand ready to assist you in bringing relief to displaced PCA members and in preserving the strength of the Farm Credit System.

With best personal regards, I am

Sincerely,

MAX BAUCUS.

STATEMENT OF ROBERT ORRICK, ASSISTANT DIRECTOR, SPOKANE OFFICE, FARM CREDIT ADMINISTRATION

Mr. Chairman, my name is Robert Orrick. I am the assistant director and leader of the Spokane District Team of the Office of Examination and Supervision of the Farm Credit Administration. I appreciate this opportunity to discuss with your committee likely changes in the Farm Credit System.

It must be understood that what is occurring in the Northwest is not unique. The problem of failing production credit associations is more severe in the Northwest thus far, but PCAs have had to be liquidated in two other farm credit districts as well. The same is true with the Spokane district's proposal to merge all of the district's PCAs into one association. A number of farm credit districts are considering broad merger and consolidation plans.

It is also important to understand that what happens in the Spokane district affects all 37 Farm Credit Banks. System securities are sold on the bond market on a System-wide basis. That means that all 37 banks stand behind the bonds sold to make loans by each bank. A System-wide capital preservation plan exists to ensure that when one bank cannot meet its obligations the other banks will see to it that bondholders are repaid. Right now the Federal Intermediate Credit Bank of Spokane is operating under an interim financial assistance plan, which involves the contribution of funds from the other 36 banks in the System.

Nor is the Farm Credit System unique in suffering the consequences of problems in the agricultural sector of the United States economy. According to the Comptroller of the Currency there are 4,117 banks classified as agricultural banks. That means 25 percent or more of their loans are agricultural. Some 450 of these banks

reported losses in September 1984, and of the 78 banks that failed in 1984, 25 were agricultural banks. Of the six banks that failed in January of this year 3 were agricultural banks, and the comptroller predicts that the number of problem agricultural banks will continue to grow.

As you know Farm Credit System institutions provide 100 percent of their lending for agricultural, aquatic and rural housing purposes and for rural electric cooperatives. In the Northwest, eight PCAs have gone into liquidation, four of them this year. Two PCAs in Nebraska and one in Kentucky are also being liquidated. In addition to the problems being experienced by the FICB in Spokane we expect at least one other FICB will need help in 1985.

The System, as a whole, is nevertheless financially sound. Those who invest in its securities have no reason to lose confidence. Despite $407 million in loan losses in 1984, the Farm Credit Banks posted $441 million in earnings. Reserves for losses at the bank level actually increased.

Investor confidence is evidenced by the continued ability of the System banks to sell bonds at very favorable spreads over Treasury.

Unlike the commercial banking system that is made up of thousands of independent institutions, the Farm Credit System is more integrated. This is necessarily so because of mutual obligations on bonds, but also because Congress intended a cooperative System. District farm credit boards serve as boards of directors for all three banks in their district. Local control of associations and banks, while a central theme of the Farm Credit Act of 1971, is not absolute, nor can it be considering the size of the undertaking and the restriction of lending to agricultural purposes.

It is important then, to review Farm Credit System problems and concerns in the context of agricultural generally and of the Nation as a whole rather than restricting our view to one section of the country or several institutions of the Farm Credit System. Furthermore, it is important to learn from the experience of failed institutions and put in place mechanisms for preventing further deterioration.

Unfortunately, the Spokane district provides examples of what has gone wrong and provides a basis for developing solutions that can prevent liquidation elsewhere.

First, I will discuss some issues of specific application to System institutions and members in the 12th Farm Credit District which includes the States of Montana, Idaho, Oregon, Washington, and Alaska. Then I would like to touch on a major effort of the Farm Credit Administration to improve its effectiveness in preventing the necessity of liquidations in the future.

SPOKANE DISTRICT ISSUES

The Farm Credit Administration has the responsibility for overseeing the liquidation of failed associations. We are, in fact, presently conducting on-site inspections of institutions being liquidated. The standards applied by liquidators are on different than those applied by other Farm Credit System lenders in the district.

There are some who feel the liquidators are applying a more rigid and restrictive standard, but to a large extent the problem was a too lenient collection policy being administered by the association that is being liquidated. As long as the liquidator is using sound business practice in discharging his function, FCA will not intervene.

One further point about liquidations—FCA is charged with the responsibility of ensuring that all creditworthy farmers, ranchers, and producers and harvesters of aquatic products have access to credit through the Farm Credit System. In liquidating associations, we have taken care to have the territories served by liquidating PCAs assigned to other PCAs so that services to borrowers will not be reduced. Even then, there are some borrowers whose loans cannot be assigned to successor PCAs and which must remain with the liquidating association. These borrowers are likely to experience reduced credit availability although the liquidator does have the authority to extend additional credit if it is purdent to do so.

Finally, I want to point out that the finanical assistance being provided to the Federal Intermediate Credit Bank of Spokane is helping to keep interest rates in the 12th Farm Credit District down. One of the negative effects of association failures is that FICB loans are not repaid and result in significant losses that must be recovered by increasing the cost of money to the remaining PCAs. The willingness of the other 36 Farm Credit Banks to help the Spokane FICB helps to limit the damage to all the farmers who continue to rely on PCAs for credit.

ENFORCEMENT POWERS

Senator Edward Zorinsky of Nebraska has introduced S. 466, which would grant to FCA the same intermediate enforcement authorities currently exercised by other

regulators of federal financial institutions such as the Comptroller of the Currency, the Federal Home Loan Bank Board, and the National Credit Union Administration. Specifically, the bill would grant FCA authority to (1) issue cease-and-desist orders, (2) levy civil penalties, (3) remove officers and directors of System institutions, and (4) sue and be sued. They would increase our ability to protect shareholders of FCS institutions, while granting the institutions increased freedom from FCA regulation of ordinary business decisions and protect their right of appeal of such FCA actions.

The enforcement actions provided for in the legislation are to be conducted in accordance with the Administrative Procedures Act. The bill contains requirements that permit persons or institutions against whom an administrative action is taken to obtain formal notice, an administrative hearing on the record, and judical review of any final agency actions.

Presently, FCA has limited enforcement powers, some of which can only be used as a last resort. It may, with the concurrence of the district board, require merger when it determines that an association has failed to meet its obligations or to conduct its operations in accordance with the Act. And, upon default of any obligation, a System institution may be declared insovlent by the Governor of the FCA and a conservator or receiver may be appointed.

At present, the Farm Credit Administration can only take action after the damage has been done. Thus, unsafe and unsound practices identified by FCA or the banks in their supervisory capacity cannot be remedied under current authorities until those practices result in insolvency, and then the remedy is to place the institution into receivership or merge it. This is not to say that in most instances when problems with institutional activities are reported by FCA that they are routinely ignored. In most cases banks and associations take corrective action. The problem occurs with a minority of institutions that refuse to take corrective action but more frequently where the corrective action is insufficient or ineffective.

The Farm Credit Administration possesses a variety of "approval" authorities, which together with supervisory activities and examination of banks and associations are "tools" for discovering and correcting problems before an institution becomes insolvent. But none of these tools carry with them the power of enforcement so that they are essentially means for persuading. The Farm Credit System, however, is too large and the times too perilous to permit regulation by consensus.

The enforcement powers are essential if FCA is to carry out the mission assigned to it by the Congress. The FCA's supervisory and approval authorities served it well when FCA was a "program administrator." But the times have changed and the Farm Credit System has matured. The enforcement authorities will formalize the appropriate arms length relationship between FCA as regulator and System institutions as private lenders. The new authorities are needed now to deal with today's crises and in the future to maintain effective discipline of an essential credit service for American farmers, ranchers, and producers and harvesters of aquatic products and their cooperatives.

These new, intermediate enforcement authorities would permit FCA to stop or alter a course of action by a bank or association which is unsafe, unsound, threatens the strength and stability of a financial institution, or violates the law or regulations. They do so within a framework that has been proven to be effective by all other Federal agencies that regulate financial institutions. Finally, the practices, procedures, and precedents exist that provide a great degree of guidance to both the FCA and to individuals and System institutions as to what behavior will lead to what result and the extent of accountability of parties of FCA supervisory and regulatory authority.

One further point—FCA endorses the concept of a federal mechanism to protect against the market distortions that can occur from liquidation on nonperforming assets. We believe that the volume of such assets that will come onto the market in some areas will otherwise cause an overadjustment in asset prices, destroying not only market values for all agricultural real estate in an area but the balance sheets of salvageable farm businesses as well.

A second effect of banks and associations carrying nonperforming assets is to drive up the interest costs on those loans that are performing. The result is a limited capacity of such institutions to hold acquired property off the market and a greater instability of land values as a result.

The Farm Credit Council, the trade association representing the cooperative leaders of the Farm Credit System, is developiong a proposal to create an Agricultural Conservation Corporation. We shall carefully study the details of this plan when it is complete and we shall then be prepared to comment on it.

In summary, it should be understood that agriculture and those who serve it are going through a difficult period of adjustment which is far from over. Some farmers will fail and so will some financial institutions and other businesses who serve farmers. But most will survive and come out stronger and better prepared for the future because of the lessons learned. One clear lesson that has been learned because of the Farm Credit System's problems in the Spokane district is that the Farm Credit Administration needs enforcement authorities which can be utilized before problems become so severe that associations are unable to recover.

STATEMENT OF AL HASLEBACHER, VICE PRESIDENT OF COMMUNICATIONS AND LEGISLATIVE AND PUBLIC AFFAIRS, FARM CREDIT BANKS OF SPOKANE

Mr. Chairman, my name is Al Haslebacher and I am Vice President of Legislative and Public Affairs for the Farm Credit Banks of Spokane. With me at the table are Rod Olson, Executive Vice President of the Farm Credit Banks of Spokane, and Herb Kelsey, Acting President of the Bozeman Production Credit Association.

I will present a brief, general overview and Mr. Olson and Mr. Kelsey will focus on specific issues relating to the stockholders in the liquidating PCAs.

Mr. Chairman, to put this hearing in perspective, it must be clearly understood that there is not a farm credit crisis but a farm income crisis which has afflicted many areas of the country now for as many as five years. As the result of limited net farm income and a dramatic reduction in farm asset values, many farmers have a sharply reduced basis for financing.

The resulting stress is severely impacting every highly-leveraged farmer and every institution that has invested heavily in agriculture which includes not just farmers but country banks and farm credit associations. This stress particularly affects the Farm Credit Banks and Associations because we are single-industry lenders: 100% of our loan assets are in agriculture.

We note that some question why the government has any responsibility in assisting farmers in these times—those farmers who made decisions to go further into debt in the mid and late 1970s. Well, they didn't count on a grain embargo; they didn't count on the value of the dollar reaching record levels and taking us essentially out of the foreign markets; they didn't count on record interest rate levels and low commodity prices; and they didn't count on successive drought years. And yes, neither did their lenders or the Congress, or the extension service or the farm press count on these occurrences, many of whom counseled expansion during the golden era of agriculture in the early 1970s.

But now it's 1985, and studies we have seen say that about 30% of the farm debt is in the hands of 12% to 15% of borrowers who are at least 70% leveraged in their business. This is the volume of farm debt that will almost certainly face liquidation in the next several years.

In addition to these highly-leveraged farmers, the current stress also impacts the agricultural infrastructure—the local feed stores, the cooperatives, the country banks, the implement dealers, and yes, the PCAs—all of whom depend on a prosperous agriculture. We note that only two weeks ago the Great Falls Tribune cited a Federal Reserve Report which said, "Fully 10% of Montana's banks are jeopardized by loan losses. Those banks with a higher percentage of agricultural loans are in the greatest jeopardy."

As these institutions are impacted—as they suffer the costs of losses on receivables or loans—the higher costs are spread among the rest of the farmers—those who weren't highly leveraged. And it is they who will pay the added costs until they, too, are unable to service their debt or they take their business elsewhere—to regional suppliers and big city banks that have a base outside of agriculture.

We cannot ignore the fact that there is a major transition occurring in U.S. agriculture—it's structure, production capacity and its markets. But as the transition continues it is imperative that it be evolutionary rather than revolutionary.

We, therefore, believe that there must be time for the transition. I say transition because there are a significant number of producers who hold a large portion of the farm debt for whom there appears to be no saving short of a Federal grant. For those leveraged over 70%, the interest bill alone is twice their net income. No amount of restructuring, interest write-downs or forbearance can save very many, if any, of this group.

Mr. Chairman, I know that no one believes that forbearance comes soon enough for them or lasts long enough. But there is a "cost of time" where money is concerned, and that is the cost of forbearance. The Farm Credit Banks have carried out

a specific policy of forbearance in the last three to five years, waiting and hoping for restored profitability.

While we have been forbearing and waiting, we have seen farmers lose the equity they had in their business—equity they could have salvaged had they liquidated three or five years ago. But the equity is now eroded by increasing debt service cost and deflated land values. In many cases PCA loan officers have not only gone the extra mile with their borrowers, but have gone to the end of the road—to the detriment of both the borrower and lender.

We have seen some lose their farms. And now a PCA member's fellow borrowers are paying the increased interest rates that must be charged if his lender is to cover the cost of carrying those farms on their books—that's what they have do to because there is essentially no market for those farms. And that higher interest rate only increases the debt service burden of the other farmers, thus weakening their own financial condition. There comes a time at which the increased interest rate becomes noncompetitive and borrowers who can find another lender will flee, thereby imposing even greater interest cost for those who remain.

Mr. Chairman, we can justify some additional forbearance to the stockholder/borrowers of these banks and associations, and to the investors on whom we rely—but only in the context of restored profitability on the immediate horizon.

However, we don't see it. Instead we see loan officers who are trying to rewrite operating loans amid the prospect of massive withdrawal of government support in agriculture. We also see an Administration that proposes a $50 million tax on farmers' access to the agency market—rising to $75 million in FY '87. Apart from the revenue, their expressed purpose is to continue raising the fee until farmers are driven from the agency market. They call it a user fee for which farmers get nothing in exchange except a higher interest bill.

Credit is the most important tool in a farming business. The PCA and the Farm Credit System of which it is a part must be kept strong. It is the primary access farmers have to the Nation's money market.

As agriculture goes, so will the institutions of the Farm Credit System go. We have done much in recent months to mobilize capital to best assure viability of troubled institutions around the country. We are not concerned about Farm Credit's ability to deal with the current level of stress. The challenge is to stop the deterioration of those credits which do have a chance for survival in the farming business. If we are to do that, the agriculture industry needs some assurance of a return to profitability and the stability of a long-term farm program that will provide time for over-leveraged operators to transit out of agriculture.

We commend you for demonstrating, through this forum, that you share the same concerns we have about the well-being of farmers and all of those who serve and depend upon agriculture for their livelihood.

STATEMENT OF ROD OLSON, EXECUTIVE VICE PRESIDENT OF CREDIT AND SUPERVISION, FARM CREDIT BANKS OF SPOKANE

Mr. Chairman, my name is Rod Olson, and I am Executive Vice President for Credit and Supervision for the Farm Credit Banks of Spokane.

As stated in Mr. Haslebacher's testimony, we are dealing with a farm income crisis rather than an agricultural credit crisis. If all of the borrowers in the three Montana PCAs had been able to repay their loans, the PCA directors would not have voted for voluntary liquidation.

The basic premise of a loan is that funds are borrowed for use by the borrower, the borrower agrees to repay this loan by contract and if he doesn't repay the loan, the lender has a right under state law to enforce its contract for repayment. Apparently what the Agriculture Credit Crisis Committee envisions is that the regulations they seek will change this, which obviously is not correct. All of us, except possibly the Federal Government, eventually have to pay our debts. Government lenders of last resort can provide debt relief or special terms for debt repayment, but even these debts have to be repaid.

PCA LIQUIDATIONS—NECESSITY AND PROCESS

The FICB of Spokane itself is in a financial crisis as a result of eight district PCAs being placed in liquidation and has been forced to seek financial assistance from other Farm Credit Banks of the System. The nonperforming loans of the PCAs in liquidation caused a $22 million operating loss in the FICB in 1984 because the FICB had to pay interest on 100% of its bond debt, but received interest on less than 90% of loans to the PCAs. When a PCA becomes insolvent or the stock is im-

paired, liquidation of the association becomes necessary because they do not have the financial capacity to continue to operate.

The respective Boards of Directors of Montana PCAs voted unanimously to place their PCAs in voluntary liquidation. FICB and the liquidating PCAs have fully complied with the statutory and regulatory requirements and procedures in placing the PCAs in liquidation. The Plan of Liquidation was reviewed with each Board of Directors prior to their decision. Each Board of Directors had the financial information with which to make a considered decision. This decision was made as authorized by federal statute and regulation. The objectives of the Plan of Liquidation as reviewed by each Board of Directors were:

A. To liquidate the PCA in an orderly and expeditious manner.

B. To maintain continuity of the association until the liquidation is completed.

C. To maximize the return from the association's assets and minimize losses to its creditors.

D. To focus both on the collection and/or improvement, which will allow collection or reclassification of nonperforming loans that are the most costly assets of the association.

E. To safeguard against a "fire sale" approach to liquidating, but rather to encourage timely, reasonable liquidation.

F. To effect an orderly transfer of active loans to the PCA pursuant to its agreement to accept these loans in a manner that will result in high quality member service at a reasonable interest cost.

The priorities for distribution of the assets in liquidation are as follows:

1. Administrative expenses.
2. Secured creditors.
3. General creditors.
4. Member equities.

Compliance with the objectives of the liquidation plan is the goal of the PCAs in liquidation. Litigation may delay the accomplishment of the goals, but it will not change them. Litigation is an administrative expense and the PCA in liquidation has a fiduciary responsibility to its total membership to defend against these suits. The bottom line in delays to the liquidation is the adverse effect on members' equities.

For comparative purposes you should know that the three Montana PCAs placed in liquidation had 1,244 members on 12-31-84 just prior to approval of liquidation. Since then 302 stockholders have paid off their loans and 86 have applied for and were approved for membership in the expanding PCAs, leaving 856 borrowers in the liquidating PCAs on 4-1-85. Only two foreclosures have been filed in Montana since the liquidation. A number of PCA applications are still in the processing stage.

BORROWER STOCK

It is doubtful that very few borrowers from Farm Credit institutions do not understand the nature of the System's capital programs. The FLB has been in existence since 1916 and the PCAs and BCs, in one form or another, since 1933. Stock requirements have been known and the case books are replete with stock litigation which establish the at risk nature of the System capital.

"B" stock is membership stock required by Federal statute as a prerequisite to borrowing from a PCA. The Federal and State Securities Act generally exempt from registration those securities issued by the United States or an agency or instrumentality thereof [15 USC 77c(a)(2), ORS 59.025(1)(3), MCA 30.10.14(1), IC 30-1434(1), IC 30-1434(1) and RCW 21.20.310(1)]. Further, 12 USC 2094 would probably preempt any regulation by states.

As to contentions of securities fraud or nondisclosure, because 12 USC 2094 is mandatory in its requirements and spells out the amount which the borrower must invest, there seems little possibility that a court would hold that a borrower had been defrauded in being required to purchase "B" stock because everyone is charged with knowledge of the law.

However, the investment nature of "B" stock became somewhat diffused by the automatic issuance and retirement program used by PCAs since 1976. To bring this back into focus in February of 1984 a brochure entitled "Your Ownership of PCA" was provided to all PCAs by the FICB to distribute to all PCA members. It clearly explains the nature of "B" stock as risk capital and explains how stock could become impaired. A copy of this brochure is attached to my testimony. Some associations immediately mailed a copy to all stockholders and others distributed them at annual stockholder meetings and at renewal time.

The action taken by the FICB of Spokane which cancelled the automatic issuance and retirement of PCA "B" stock at Milk River PCA and Western Washington PCA on December 20, 1984 and Glendive PCA and Western Montana PCA on December 26, 1984 was authorized by the Bank's board of directors on December 19, 1984. The action was taken after Bank management's review to the board of the adverse financial conditions of these associations. The cancellation action was recommended by Bank management.

The cancellation action, and the subsequent freeze on the issuance and retirement of "B" stock and other PCA capital, is a subject of great concern to the associations' boards of directors, officer and employees and members or holders of associations' capital. Informational meetings have been held both by Bank and borrower groups but it still appears that there is a wide divergence of opinions on the entire subject of PCA capital.

The areas of concern which have been raised are:

1. PCA capital.
2. Actions taken by FCA, FICB of Spokane and liquidating PCAs in relation to the member stock of Puget Sound PCA, Southern Idaho PCA, Southern Oregon PCA and Willamette PCA.
3. Actions taken by FCA, FICB of Spokane and liquidating PCAs in relation to Glendive PCA, Western Montana PCA, Western Washington PCA and Milk River PCA.

PCA CAPITAL

PCAs have a variety of capital accounts. These accounts are authorized by federal statutes (12 USC 2094 and 2095), FCA regulation (12 CFR 615.5250) and association bylaws (PCA Standard Bylaws Articles VII and VIII). The accounts authorized are unallocated surplus, allocated surplus and "A, "B", "C", and "D" stock. All capital accounts are addressed by the Bank's and associations' financial departments under generally accepted accounting procedures and can be designated under the books of the associations with other name categories such as, "reserves for loss or other purposes" or "paid in surplus".

The one thing common to all capital accounts is that the accounts are at risk and the application of association net earning or losses impact these accounts based on federal statutory priorities. The Federal statutes and associations' bylaws provide the rules and priorities for application of earnings or losses and for the restoration of impairment of the various capital accounts. These capital statutes are not permissive but are mandatory in application.

The "at risk" priorities are as follows:

1. Unallocated surpluses.
2. Allocated surpluses.
3. Class "D".
4. Class "B" or Participation Certificates (Member).
5. Class "A" (Member).
6. Class "C".

When a PCA member borrows from the association, he is required by statute to purchase the necessary capital to support the loan. Under the present statutes, the required capital investment is up to 10% of the loan. The member can pay for the stock purchase or borrow the funds to pay for the stock purchase. The latter is the more traditional procedure.

I want to cover very briefly the background for stock retirement prior to the institution of the automatic retirement program in 1976. Under the present Farm Credit Act, PCAs have the authority, pursuant to 12 USC 2094(f), coupled with PCA Bylaw 750(3) and with the approval of the FICB, to retire excess capital. This was also authorized under prior federal acts relating to PCAs.

Prior to the institution of automatic retirement, excess stock was either retired by action of the PCA board on a bi-annual basis, converted into "A" stock or retired at the request of the borrower.

With the computerization of the PCA financial activities in the Bank, a program was developed which could be adopted by PCAs to automatically issue and retire "B" stock as loan advances and repayments occurred. This program was adopted by all PCAs except one after approval by the FICB and FCA. Comprehensive procedures were published at the time for "B" stock handling both for automatic and manual. The new program was instituted at about the same time as the new service of issuing a quarterly computer printout of member transactions. The summary of transaction reflected purchases and retirements of "B" stock or Participation Certificates as well as all other loan activities. The Summary column for these entries

was headed "Investments in PCA". This program is still in force, although it has been modified from time to time. This was the program cancelled at Glendive, Milk River, Western Montana and Western Washington PCAs in December. It was also cancelled at Puget Sound PCA, Southern Oregon PCA, Southern Idaho PCA and Willamette PCA.

ACTIONS TAKEN BY FCA, FICB OF SPOKANE AND LIQUIDATING PCA'S IN RELATION TO PUGET SOUND PCA, SOUTHERN IDAHO PCA, SOUTHERN OREGON PCA AND WILLAMETTE PCA

These associations, because of adverse financial conditions, were placed under FCA procedures (12 CFR 611.1140) in the summer and fall of 1983. The procedures included cancellation of the automatic program and a freeze on the issuance and retirement of "B" stock and participation certificates.

Subsequently, in late August and early September, FCA placed Southern Oregon PCA and Puget Sound PCA in receivership (authority 12 CFR 6711.1130). It was FCA's intention to take this same action with Willamette PCA, but the litigation of the association's review procedures prevented this action. It also became financially apparent at this time that Southern Idaho PCA would also have to be liquidated.

The Willamette PCA litigation was put on hold in November 1983 pending a new review of the association's financial condition. This was the subject of the Interim Settlement Agreement entered into at that time between the FICB of Spokane and Willamette PCA. With this Interim Settlement Agreement in place, FICB management had the opportunity to further assess its own, and the District PCA's, operational financial position and institute forward planning for the Twelfth District FICB/PCA Viability Plan. It was apparent that the changes in FICB management in July, the almost concurrent action of FCA placing the four associations under procedures, the subsequent liquidation of two associations and the existing and potential litigation was seriously eroding the ongoing operation of the Bank and associations in the District.

Bank senior management met with FCA senior management in mid-November to assess operations and litigation. It was determined at that time by FICB and FCA that voluntary liquidation of Southern Idaho PCA under 12 CFR 611.1130 would be much better operationally than another FCA receivership. In order to accomplish this voluntary liquidation, and to minimize potential legal actions resulting from the freezing of "B" stock, the FICB, with the concurrence of FCA, made the business decision to write down its loans with Puget Sound PCA, Southern Idaho PCA and Southern Oregon PCA to a level that eliminated the impairment of "A" and "B" stock in those associations. The Bank concurrently authorized retirement of "A" and "B" stock by the associations. At that time, the Bank had the financial capacity to accept the loss and considered it prudent to take this action. This action was augmented in early December of 1983. A further decision to write down the FICB loan was made as a part of the Willamette PCA litigation settlement. The Bank's financial condition in May of 1984, was still such that the write down was considered as a prudent business decision. The total write down for all four PCAs was approximately $9.5 million. All of these actions were taken by Bank's management with the approval of its board of directors after a review of applicable facts and conditions.

ACTIONS TAKEN BY FCA, FICB OF SPOKANE AND LIQUIDATING PCA'S IN RELATION TO GLENDIVE PCA, MILK RIVER PCA, WESTERN MONTANA PCA AND WESTERN WASHINGTON PCA

Based on the financial condition of these associations, as reported by Bank management to the FICB board of directors on December 19, 1984, the automatic retirement of member stock was cancelled on December 20, 1984 for Milk River PCA and Western Washington PCA and on December 26, 1984 for Glendive PCA and Western Montana PCA. Reports to association boards of directors on their respective financial condition were made on those dates. Subsequently, as detailed in prior memorandums, the boards of directors of these associations requested the FICB and FCA to place the associations in voluntary liquidation. The Bank and FCA approved the board requests and on January 16, 1984 the formal FCA authority for liquidation was received by the FICB and the associations.

The FICB was requested by the association boards to consider writing down its loans for the impaired associations (Milk River PCA and Western Washington PCA) and authorizing the retirement of stock upon payoff of all borrower loans. The FICB financial condition had deteriorated substantially since the prior write down decisions were made in December of 1983 and May of 1984. The Twelfth District FICB/PCA Viability Plan had not been approved by FCA because of this financial stress. The Bank's current financial condition and projected losses negated a further busi-

ness decision that additional risk capital could be retired. It would not have been prudent for the Bank's board of directors to take this action.

FINANCIAL ASSISTANCE AND DISTRICT RESTRUCTURING

We have talked a lot about the "B" stock issue. However, of even greater importance to a larger number of 12th District PCA members is the issue of FICB viability. As you know the FICB of Spokane has requested financial assistance from the other Farm Credit Banks in the System. An interim Financial Assistance Package of $25 million is in place and being utilized and a long-term assistance program to handle up to $300 million in high risk loans is being considered.

To qualify for this assistance and to position ourselves to be viable and more competitive, a district reorganizational plan has been proposed. This plan includes the mergers of 23 PCAs to one districtwide PCA and 40 FLBAs to one districtwide FLBA. It also includes the consolidation of PCA and FLBA management and staff to form "one-stop" credit service for all Spokane District Farm Credit stockholders.

Sixty-two of the 63 PCA and FLBA boards have agreed to proceed with the district plan. The Farm Credit Administration and the Finance Subcommittee support the plan and state that financial assistance is conditional upon implementation of the plan.

Both a joint management committee and a joint director advisory committee have been and continue to be the developers and directors of reorganizational efforts. Following objectives established by these committees, a district structure and means of implementing this structure have been established.

Basically, the plan is two fold. First, like associations (PCAs and PCAs, and FLBAs and FLBAs) would be merged into one association. For PCAs all assets, risk capital and surplus would be combined to allow maximum risk-taking ability in all geographic areas. This is especially crucial in the liquidating areas where expending PCAs have limited risk-taking ability. Mergers should increase the service and amount of money lent in the liquidated areas.

The FLBAs have operated under this shared capital concept; therefore, the mergers of FLBAs has a limited impact on risk-taking ability in delivering long-term credit.

It is important to note that this financial merger does not allow for the merger of PCA and FLBA assets. The two must exist as separate financial and legal entities. This means that FLBA member stock will not be affected by PCA losses or liquidations.

Secondly, the management, staff and offices of FLBAs and PCAs would be consolidated to provide farmers and ranchers with one-stop services. This consolidation allows for the most cost-efficient use of capital and staff time. For example, loan officers who previously provided for only the long-term needs of a borrower will now be responsible to provide for the short-term needs as well. This coordination of credit service will benefit borrowers as the time needed for loan investigation, analysis, and servicing will be reduced. Cross-lending is beneficial to association opertions since peak times in business vary for different types of lending.

Other components of the program loan pricing where the cost to the association of servicing the loan and taking the related risks parallel the interest rate charged to the borrower. This allows for an equitible spread of association expenses.

As cooperative organizations, PCAs and FLBAs have operated under the direction of member-elected directors for each association. This practice will continue under the proposed structure. Voting stockholders of the FLBA and of the PCA will each elect their own six-member board of directors. The FLBA and PCA boards will perform the same functions they do now, and joint board meetings will be held to provide for operational efficiencies. There will be greater emphasis placed on delegation and redelegation, and a much closer working relationship also is expected to be established with the district board.

The one PCA/one FLBA structure initially will be comprised of six operating regions. These regions will contain service centers which will be directed by local associate directors, performing certain functions under authority delegated from the PCA or FLBA board. Loan approval authority will be delegated appropriately to the local service center boards.

Although current association directors have agreed to proceed with the reorganizational plan, all stockholders must vote to merge their associations. In May, each stockholder will receive information explaining the merger and how it will impact their association. Starting in June, each stockholder will be asked to attend individual association meetings to cast their vote for or against the merger.

Our goal is completion of the reorganization plan by September 1 so that the "one stop" credit service to be offered by the "Farm Credit Financial Centers" will be in place and functioning smoothly by the beginning of the fall refinancing season.

Mr. Chairman, the lending industry along with the agricultural industry is suffering financial stress at record levels. We believe the Farm Credit System can solve its own problems and weather this economic storm providing that the transition in agriculture is evolutionary rather than revolutionary. Therefore, we urge you and your colleagues in Congress to pursue the course of change at a moderate rate.

Attachment.

YOUR OWNERSHIP OF PCA

A Production Credit Association (PCA) is a lending institution owned by the farmers, ranchers and commercial fishermen who borrow money from it. PCA members must purchase stock in their association. This "B stock" provides a capital base for the PCA.

The use of B stock to capitalize the association was developed to assure the PCA's borrowers would have ownership in their cooperative. The use of B stock allows the PCA to provide its members with dependable agricultural credit at competitive rates. In addition, a PCA member holding B stock is eligible to participate in the election of the PCA board of directors. The board establishes policies and provides direction for the association.

When a PCA member borrows money, he may purchase B stock outright, or the PCA will loan the money to purchase the B stock. If a member elects to borrow money from the PCA for the B stock, he incurs a liability to repay that money and he must pay interest on the total amount of the loan, which includes the B stock purchase. The amount of B stock purchased is directly proportional to the amount of money borrowed. As the outstanding balance of the loan is increased, the PCA automatically issues an appropriate amount of additional B stock. As the loan is repaid, the stock is normally retired.

Because B stock comprises a portion of the PCA's capital base, there is a possibility that automatic retirement could be cancelled or the stock could become impaired. Essentially, impairment means the stock value has declined below par value, which is $5 per share. If a PCA were to suffer loan losses which exceed its bad debt reserve and surplus accounts, the B stock would be impaired. Obviously, the PCA does not anticipate the stock will become impaired. However, it is important for the PCA member to understand that under certain circumstances, B stock is subject to decline in value.

PCA members nationwide have pledged their own capital for 50 years to make PCA the single largest source of operating credit in the U.S. This has proven to be a sound investment. PCAs have grown and prospered during this period.

Based on the long-proven cooperative principle, PCAs provide farmers, ranchers and commercial fishermen with their own source of short- and intermediate-term credit. It is vital for each member to understand that he owns a portion of the PCA and has a voice in its operation through the elected directors.

STATEMENT OF JOHN N. LAWYER, PLAINS, MT

The Western Montana Production Credit Association (WMPCA) is being liquidated by the Federal Intermediate Credit Bank of Spokane (FICB). We, as stockholders in the WMPCA, are being told that the WMPCA is insolvent that we no longer have a viable association, that our B-Stock in that association is not redeemable, and that it probably will have little or no value if and when it is redeemed. All the assets of the WMPCA, including loans of all categories, buildings, automobiles, etc. are being "sold" without representation from the WMPCA stockholders, and we the stockholders believe, without a proper legal basis for such actions.

Given recent comments of senior management, the Federal Intermediate Credit Bank of Spokane (FICB) appears to be absolutely broke. Furthermore, it is highly questionable whether or not the other banks in the Farm Credit System (FCS) can or will provide enough financial support to the Spokane bank to salvage it as a viable entity. There is every indication from other Farm Credit districts that a high level of financial stress exists throughout the entire Farm Credit System (FCS) due primarily to the overall stress in agriculture at the present time and from past policies of liberal lending and poor management with the FCS.

The paradox in this situation is that the bonds that support the entire FCS continue to sell as though the system is financially sound. Furthermore, the Federal Farm Credit Banks Funding Corporation as well as the Governor of the Farm

Credit Administration (FCA) continue to pronounce the system to be financially sound and very solvent. In fact, they say it earned $425 million in profits last year even after record high loan defaults.

Now someone isn't telling the truth! Whom do we, the stockholders, believe?

Is the FCS really solvent, or is it broke, or is it under severe stress? We want answers to these questions immediately.

To the stockholders of the WMPCA this is a $4.6 million problem—we want our B-Stock redeemed. To Congress, to the American Public, to Senator Melcher, yes, even to President Reagan, this is a $90 billion problem, and it will require congressional action to correct it.

We believe that the entire FCS is in very big trouble. Regardless of all the accusations and verbal conflict, it doesn't lessen the fact that it is in trouble. The FCA and FICB officials may try to tell you that they don't have a serious financial crisis, that they can handle the problem, but they do have a problem and they can't handle it. There is not only a very serious financial crisis in the entire FCS, but there is also in management. Most importantly, there is a diminishing faith in the system by increasingly large numbers of member/borrower/stockholders at a time when they need a responsive farm credit system the most.

Unless these problems are addressed, the situation will continue to deteriorate and may well lead to an overall collapse of the entire farm Credit System. What is most disturbing is that this can be avoided, but I believe only with intervention by Congress.

My report is largely a compilation of talking to perhaps a hundred people, intimately familiar with the Farm Credit System, reading every report and document I could get my hands on, and finally, observing the system from the bottom looking up. This is a "grass roots" perspective, but not unfounded.

PROBLEMS IN THE FARM CREDIT SYSTEM

Credibility problems

The Farm Credit System is increasingly suffering from a devastating lapse in credibility to the member/borrower/stockholder and possibly to the public and bondholder as well. This credibility problem arises from a lack of comprehensive information, misinformation, and misleading statements by FCS management. It is also from actions by FCS management that are not in the interests of the stockholders, such as obviously one-sided rules and regulations, defensive statements by management, attacks on stockholders by management, secretive acts by management, possible illegal acts by management and the increasing apparent lack of leadership at the level of the district banks, and above.

The stockholder can see that the system is in very serious trouble and to varying degrees the mamagement of the various banks reinforces that perception by denying that there are problems.

The financial burden of the collapse of the Farm Credit Banks is being placed on the stockholder first. We believe that the FICB in Spokane is scrambling to acquire as much cash and liquid assets as possible, by forcing the PCA's into "voluntary" liquidation. Such liquidations are obvious to the stockholders to be coerced and forced, and this in itself destroys the credibility of bank management.

The B-Stock issue erodes credibility even more. Freezing the B-Stock is an obvious ploy on the part of the bank to place the financial burden of the bank's problems directly on PCA stockholders. The fact that B-Stock was redeemed in four PCA's placed into liquidation in 1983—Willamette, Southern Idaho, Puget Sound, and Southern Oregon—is a direct contradiction that the stockholder is in fact financially responsible for the supposed insolvency of his own PCA association.

PCA's are a unique corporate entity where the stockholders are also the only customers; this being a very different situation than what would normally exist in a comparably large corporation. This requires very special treatment on the part of management, since the stockholder is not only the present customer but also the best prospective future customer as well. The handling of stockholder's rights with respect to their B-Stock is a particularly sensitive and important issue. By freezing the B-stock and not redeeming it at par, the FICB has effectively destroyed the faith of the stockholder in the management of the system and permanently alienated him from considering the bank as a further source of capital. Stockholders and customers no longer have the very basic trust in management that is essential to any financial banking institution.

As this situation becomes increasingly apparent to borrowers in other viable PAC's, there will be a run on the bank. Those borrowers who are the most credit worthy will leave the system permanently. This will leave the FCS including PCA's

and FLB's as a lender of last resort to those farmers who are unable to acquire credit from other sources. We know from our survey that 85% of the WMPCA stockholders now prefer financing outside of the Farm Credity System if they can get it!

The FCS/FICB appear to be afraid of a loss of confidence by the borrower. Their current public relations campaign includng a six-page advertising spread printed in the Farm Journal saying that the whole system is sound and solvent, makes the stockholders question the intentions and integrity of the bank officials. What is needed is "straight talk" to the stockholders that states specifically and in detail the financial condition of their local PCA, their FICB and the condition of the overall Farm Credit System.

We have experienced, here in Western Montana, the resistance of our local management, as well as, the FICB in Spokane, to willingly give requested information of us as stockholders, to which we have a legal right. Also, in talking to PCA stockholders around the country, it is very apparent that this pattern exists throughout other Farm Credit Districts, especially those under severe stress. For example, stockholders have a right to a list of other stockholders, to a copy of their Association By-Laws, and should have rights with respect to detailed financial information on how their associations and the banks are being managed and run. We have been told more than once, such information is proprietary and cannot be given out. It was only after obtaining legal guidance that we were able to obtain our WMPCA stockholder list.

Such acts on the part of the bank only further erode their credibility with the member/borrower/stockholders. We want open and direct communication at all levels. We don't want a public relations campaign. We don't want misinformation. We don't want to be denied access to information. We feel it is our right and it will further the cause of reestablishing a credible Farm Credit System if better communication between bank management and the stockholders is established. We don't have a mechanism to establish such communication but the FICB does. It is their responsibility!

Furthermore, we need, as do other stockholders throughout the Farm Credit System, clear and explicit detailed statements on our rights as a stockholder to such things as rights of appeal, rights of forebearance, access to corporate minutes, copies of various rules and regulations affecting us, access to our own loan files, and any other information that can assist us in solving our own particular finanical problems.

It appears that FCS management does not want stockholders to openly communicate with each other. They are afraid of this; that it will erode their credibility and damage the system. However, such communication is unavoidable. We will establish nationwide communication among all PCA stockholders to the extent necessary to get our B-Stock redeemed and our goals accomplished.

We are told by FCS Management that our PCA is (or was) a cooperative. The cooperative structure was established by Congress to run with the management and control of the various associations and banks as close to the stockholders as possible. However, the system has been gradually taken over by the bureaucracy. The various boards of directors are now largely ineffective. How can they be effective when FCS management makes their own rules? For example, they can arbitrarily dismiss an entire board of directors or an individual member. This is unconscionable and violates the most basic concepts of democratic participation by the stockholders. If in fact the FCS is to function as a cooperative, local control and management must be effectively reinstated.

Since 1971 there has increasingly been an erosion of the power to control the local PCA by the local board. This is illustrated by the many rules vesting power in the FICB rather than with the local boards to oversee the management of the local associations. Furthermore, this transfer of power is increasing, as demonstrated by the recent proposed rules on liquidations as published in the Federal Register on February 13, 1985 (12 CFR Part 611). These new proposed rules, if enacted, would give the FCA and FICB enormous new raw power. They woud have the power to issue cease-and-desist orders and to acquire property without due process. The proposed rules fail to provide for rights of appeal, for stockholder representation and participation in liquidations of either PCA associations or of Federal Intermediate Credit Banks, and for proper accountability to the stockholders with respect to the disposition of their assets.

Senator, we must have your immediate and fullest efforts to keep these new regulations from being put into place without revision and prior public hearings in Washington D.C. and in Montana. Such one-sided rules are especially unfair when they are proposed during a time of crisis.

Recent actions taken by the FICB on the basis of their rules are often heavy handed and unilateral. For example, the decision to close our local PAC had no participation by the WMPCA stockholders and minimal participation by our board of directors. It is inconceivable that such a situation could occur in eight separate PAC's in one district if the local boards were really effective.

At the present time, we as stockholders have no participation in the liquidation process. We have no appeal rights with respect to the liquidation. FICB actions have been based on audits internal to the system and those audits, according to bank management, are not subject to review of negotiation by anyone.

Finally, those of us who have taken an active and aggressive role in bringing this information to the public and to the stockholders are deeply concerned that many WMPCA stockholders have expressed their concern and are afraid to attend meetings such as this for fear of reprisal by their various loan officers of FICB management for participating. We believe that the FICB and WMPCA management should avoid even subtle actions on their part and should assist us and encourage people to participate in our efforts. Only then can our trust in the credibility of management be restored.

District status meeting January 3-4, 1985

I wish to pause now and discuss one of the most important documents that we have reviewed in our study of the Farm Credit System in the 12th District. We have a copy which we submit to this hearing, of the verbatim transcript of the FICB District Status Meeting held in Spokane, Washington, on January 3, 4, 1985, at The Ridpath Motor Inn. This meeting was chaired by senior FICB management and attended principally by the Presidents of various PCA Associations. We estimate that there were approximately 50-60 people present. The document is rather imposing to read. However, several of us have read this in detail and it gives incredible insight into the management capability and the chaos that presently exists in the bank and to some extent the outlook with respect to our Farm Credit System.

We urge the members of this U.S. Senate Committee and the press to read this for themselves and make own judgment in addition to our comments. We think that you will draw the same conclusions that I am about to present.

It is obvious from their meeting that the management of the FICB in Spokane is in absolute chaos. There is no credible management in place and apparently this has been the case for months, possibly years. The attempts to consolidate management may help alleviate this problem temporarily, but we suspect that the same problem exists throughout the entire FCS. The meeting itself appeared to be very unorganized with a great deal of anger and frustration expressed by people under extreme stress. It appears that senior bank management had no credible plan to present, no organized structure to the meeting, no perception of the details of where they were heading or how they were going to solve their finanical problems. It was as though they were saying, "Well, boys, what shall we do, we don't know what to do. . . ." It appears to us that FICB management has been looking for a solution, but they don't have one. We can now conclude that the management of the FCA is in a similar state and has very little idea how to proceed to solve the current farm credit crisis.

The FICB in Spokane, according to the transcript of this meeting, is flat broke!

Furthermore, there is little hope that this situation can be resolved. Their plans presented in late 1984 to make the bank solvent again were rejected both by the FCA and apparently by other banks in the system. We therefore conclude that the decision to close individual PCA's was nothing more than a scramble for cash on the part of the FICB. They saw the B-Stock and loan portfolios as an easily accessible source of liquid assets.

The FICB is apparently losing something on the order of $800,000 per month, possibly more. This cannot continue without completely destroying the FICB in Spokane and possibly the entire Farm Credit System. This fact and its consequences were recognized in the meeting as stated in the transcript. But what is lacking is a viable management plan to deal with this crisis.

During the course of the District Status Meeting senior bank management makes it abundantly clear that they knew which PAC's in the twelfth district were in serious financial trouble months before any were placed into liquidation. This means that they condoned the continued selling of B-Stock in associations which were not financially viable and in which they intended to freeze the B-Stock at some later date. According to our understanding of the most basic concepts of the securities laws, this is illegal. We think that the FICB understood this and that this was discussed in Spokane, yet B-Stock was issued anyway and sold—right up until the very day it was frozen.

Furthermore, in this transcript they name the additional PCA's that will probably be closed in the near future. These include Central Montana, Western Idaho, and Northern Washington. In addition others under extreme stress include Mid-Columbia, Lewis-Clark, Northwest Montana and Northern Washington. According to FICB management there are only seven PCA's in the twelfth district that are, in fact, strong and viable. The reason this information is not made public, according to the transcript, is that there would be a run on the bank. This would be the result of sound borrowers getting out and moving to commercial banks for credit. But we believe that this is already happening and will continue to happen!

One final interesting point concerns the impact that the collapse of the FICB in Spokane would have on the bond market. One senior bank official stated that if the Spokane FICB were allowed to fail, it would decrease the bond rating to such an extent that it would cost the FCS somewhere between 400 and 500 million dollars a year in additional interest. Now how can management possibly risk a 500 million dollar per year increase in interest costs to save 13 million dollars in B-Stock? This doesn't make sense, because by freezing the B–Stock they are destroying their credibility and customer base and thereby destroying the Farm Credit System in the twelfth district.

Management problems

Beginning with the Farm Credit Act of 1971, the control of the Farm Credit System has increasingly been taken over by the bureaucracy, especially by increasing the power other FCA and the management in the district banks. Gradually the FCS has ceased to function as an effective cooperative structure. Although the various boards were in place and did exert some influence, there was a gradual erosion of control from the boards into the hands of management.

Many people believe that this was a concerted and planned process, though I for one do not subscribe to that theory. I think it is the natural evolution of a large bureaucracy where there people who are familiar with the numbers and the details and are aggressive and assertive gradually take control. The system became far too complicated for members of the district and national boards to understand all the details necessary to be effective in controlling the managers. Board meetings became stamps of approval for the various plans of bank and FCA management. It is this concentration of control that many of us believe is now largely responsible for the severe stress in the system.

As this bureaucracy evolved, it was only natural to want to generate a larger power base and more bureaucracy. During the 1970's there was a very bullish attitude in agriculture and this was certainly apparent throughout the Farm Credit System. There was lots of encouragement from the top of the FCS for growth at the bottom. This was not only happening, but it appears such growth was actually out of control. PCA's and banks were advertising for borrowers with little regard to their management abilities and failed to consider possible financial problems once the economy, as would be expected, swung the other way. The boom couldn't last forever and FCA/FCS management was just as naive as the American farmer.

Progressive FCA/FICB management spent enormous amounts of money in the past decade to stimulate this growth. Progressive management was deeply concerned with image building to make the FCS appear competitive with large commerical banks. Past expenditures that now look foolish include large fancy buildings and airplanes. In general things were proceeding in a rather reckless charge to make the system bigger and bigger. All indications are that "empire building" was and still is going on.

Furthermore, this headlong charge to bigness not only got the sytem in trouble but it will continue to keep it in trouble until the problem is recognized, not only by us but by FCA management.

There appears to be a lot of infighting going on between the management of the various banks. There are struggles for power, for influence and for control. This is taking place not only in Spokane but also between districts and between bank managers and the FCA. Why is this occurring? Can the situation be changed? We believe it can. Senior management must be replaced at the Spokane banks and at the FCA in Washington, D.C. As professional financial and business managers it is apparent to us that many of these people are in over their heads. They are out of their depth.

By analogy the current financial problems of the FCS are similar to those in a large corporate conglomerate with many divisions or separate companies, some of which are losing money. Competent management in a conglomerate would take aggressive and decisive action to stop the hemorrhaging occurring in specific profit centers. The first order of business would normally be to sell assets while at the

same time building and increasing cash reserves, minimizing losses and most importantly retaining the confidence of the stockholders and customers. But in the case of the Farm Credit System the stockholder is the customer, and that is where our problem lies. By freezing the B-Stock and refusing to redeem it, management is alienating the customer base. It seems to us that what should be done is an immediate effort by the FCA and all the Farm Credit Banks in Spokane to sell off all nonessential assets, such as the building in Spokane, and bring about an immediate infusion of money from whatever source is necessary to turn the situation around.

FICB managers in Spokane are making life and death decisions on people's futures and they are largely unqualified to do so. Most of them have no commerical banking experience, although some do have agricultural banking experience. The fact remains that a great many people in the FCS are not functioning with an adequate level of training, experience, or supervision. Apparently what has contributed most to this is the lack of outside blood. The FCS is inbred, since most people in responsible positions at the district banks have come up through the ranks.

From 1971 to 1984 we see in general an increasing lapse on the part of local PCA management to deal with the nuts and bolts of good financial management. PCA loan officers were mainly new graduates who apparently had little additional training outside of the Farm Credit System. Since these people eventually became managers through promotions even to the district banks, we also see that the pattern persisted clear on up through the ranks. Pressure from above to increase loan volume while failing to train people to undertake proper credit management, resulted in a lack of competent skill in financial management at the local level. Credit management during this period was taken out of the hands of the loan committees with farmer/director participation and turned over to "staff" loan committees.

During this same period, loans were made without proper analysis of the ability of the borrower to service his debt profitably or to manage his budget. In many if not most cases there was little follow up by PCA to see that the borrowers' management and cash flow plans were actually implemented and followed. The decision to loan money was largely based on collateral financing since this was the easiest way to increase loan volume. (This, of course, rode on the tremendous inflationary spiral of land values and actually helped fuel it.) This is directly the opposite to the way I understand the system originally ran when it was set up in the thirties when farmers were made unsecured loans and their management abilities were the basis for making such loans.

Today we find that the borrowers' own management has been poor, the loan officers' management has been poor, and this has resulted in a lack of competent management being carried all the way to the top. As these people moved up through the ranks they took with them confidence in their own decisions because during the seventies everything was rosy. However, when the crash came they couldn't handle it.

The response to FCS problems that we have seen in the last three or four years has been for people in control of the district banks and FCA to attempt to resolve the problems by increasing the amount of control they have at the local PCA. For example, by-laws of the local associations have been rewritten giving more power and control to the FICB. Members of local boards of directors have been threatened with dismissal if they were not cooperative with FICB officials. The number of members on the WMPCA local boards was reduced from 7 down to 5 members in the summer of 1984. Also, prior to placing a PCA into liquidation the FICB removed the local president and installed their own, apparently as a matter of policy.

Credit management also moved to Spokane as the situation worsened. This only aggravated the problems because people making decisions were not in touch with those being affected. The local boards by now had lost almost all control over the local financial management. As the planned FICB liquidation approached for each PCA, there was first an unjustified grab for collateral on all loan renewals.

Loans were apparently limited to short term renewals. The FICB in late 1984 was structuring loan portfolios at the WMPCA to maximize available collateral before they made their move to close the WMPCA. They failed to inform borrowers about FICB or WMPCA financial problems even though many people asked. Some people had enough foresight to see what was coming and paid off their loans. We believe that some even had inside information from local officials that the B-Stock freeze was coming.

Financial problems

It appears to us that there is plenty of money. The problem is not money but power over the control of money. Again, going back to my analogy of a conglomerate with many small companies each being a separate profit center. It would appear that the WMPCA is effectively being sold and the B-stock taken to bring capital to

the FCIB bank in Spokane. There is no other rationale. The FICB in Spokane is scrambling for cash and taking it out of the stockholders' assets. Congress should put a stop to this carnage at once.

The FICB says the problem is not enough capital in the FCS available to Spokane. They are operating at a loss of about $800,000 a month and no one is going to rescue the FICB with enough money to re-capitalize it. This means that the par value of our B-stock is near zero. Bank officials have said this repeatedly, yet, they are contradicting themselves and telling stockholders in letters that they will eventually redeem the B-stock.

We know for certain that loan volume is plummeting both in the twelfth District and probably everywhere. This will surely bring about a major change in the financial position of the Farm Credit System. FCA says that they are not now in trouble, that they are solvent but they are conducting a stress study anyway (ready by April 1) to determine their true financial strength. One must remember that this is an internal audit and is certain to be biased. The financial strength of the FCS may look good based on their own audits, but we suspect phony accounting, possible fraud, and misappropriation of funds. FCS auditing themselves was severely criticized in a GAO Report in the early 1980's. Until this situation is changed, there can be no hope for those outside to know the real strength of the system.

Dr. Neal Harl, a Professor of Agricultural Economics at Iowa State University, says that ten of the twelve districts in the Farm Credit System are in trouble. In fact, he names them. Spokane is certainly the worst, but behind Spokane come Omaha, Louisville, and Wichita. If Spokane were to fail completely, the others would surely follow. Omaha appears to be in about the same condition Spokane was a year ago.

We would like to know why the revolving fund kept in the U.S. Treasury is not being used to bail out the Spokane bank? The line of reasoning and the answer that FCA Governor Wilkinson gives are not adequate. This fund is available.

If used, it apparently results in some loss of FCA control. Perhaps that is the reason the Governor is unwilling to act. But, a 126 million dollar infusion is better than nothing. If it were used for nothing more than to redeem B-stock in defunct PCA's it would be money well spent. We believe that Congress should act not to force this to happen.

Based on their own financial statements, the Farm Credit System has a positive net worth of several billion dollars. The WMPCA stockholders helped create that net worth, they own part of it, and they have a right to it. We are demanding access to a portion of that net worth to redeem our B-stock.

Is the strength of the bonds vulnerable? We believe the answer is yes. Investors are too comfortable in their belief that the bonds can't fail. Since the Federal Government doesn't guarantee the bonds and there is only an implied guarantee that Congress would never let them fail, we would say, investors beware! Bond holders, whether they be individuals or large financial institutions, may be in for a rude awakening!

Several sources have told me that if the true risk of the bonds was reflected in their interest rate, it would effectively increase the interest costs of the bonds by 2 percentage points and this would destroy the entire system. Rumor has it that the Federal Treasury is buying the bonds to prop them up. No one can understand why they continue to have a high credit rating when the whole system is collapsing at the bottom. This only further illustrates the incredible magnitude of the problem.

Proposed solutions

In the final portion of this presentation I wish to present solutions proposed by the Farm Credit System and by ourselves with respect to the current situation. We are not experts on these problems but we certainly believe it is legitimate for us to comment on the proposed solutions by the FCS and to offer some of our own.

Starting at the PCA level, and looking at what is going on in PCA's liquidation. We believe that the liquidation of the WMPCA should now be carried out as quickly as possible assuming that liquidation is the proper course to take. (We are not fully in a position to ascertain that, considering the present situation.) In any event, if it is going to be liquidated, there should be full representation and participation by WMPCA stockholders in the liquidation process. Buildings and automobiles should be sold immediately and the staff should be moved into other modest quarters. Borrowers should be given every possible consideration to minimize the adverse impact on families, and on farm operations by providing forebearance while people arrange new financing. It appears that liquidating of individual borrowers is being carried out to maximize the immediate cash infusion into the bank now rather than to minimize the net losses to the stockholders. In may cases a moderate interest write

down two, three, or four years work out time would effectively allow many people to survive that are now being liquidated.

With respect to the B-stock, we want it redeemed immediately! The source of the funds to redeem the B-stock can certainly come from somewhere within the Farm Credit System. The revolving fund, other banks, the FCS, profits retained in the system, liquidation of FCS assets, etc.

The proposal by the FICB to form super PCA's is in effect a form of branch banking. This will remove all remaining semblance of a cooperative. It appears that the FCA and the FICB's are headed towards the concept of full service banking including credit cards, checking and savings accounts, insurance, and investment advice. Although many people are concluding that this is part of a grand plan to turn the FCS into a large commercial bank, we believe it is just the result of the natural progression of larger bureaucracy.

Such a monolithic concentrated power structure will increase the risk to the bond holders, rather than decrease it. As management is consolidated and merged, it opens up an ever increasing risk of mismanagement by fewer and fewer people. It was the diverse management and locally controlled financial structure of the FCS that allowed it to begin and operate in very adverse times. Therefore, we wish to go on record as being opposed to any attempts to concentrate this power further, especially the concept of super PCA's.

We do support the concept of pooled risk, since that is fundamental to the system. In fact the problem right now is that the risk, although it is supposed to be pooled, is not being managed that way. For example, WMPCA contributed to loss sharing in other PCA's but is not receiving such in return.

With respect to the Farm Credit Banks, we are not able to state a position on the concept of merging bank resources and management. What we can say is that we want the control which has been moved from the local associations to the banks, to be restored to the local association level. Furthermore, we want the development of proper rules and regulations to control the power that the bank can assert over the local association. Their role should be mainly advisory, not to run the day to day operations.

In order to solve the financial crises in Spokane, we believe that the first order of business should be new management: New management for strength, new management for investor confidence, and new management for renewed confidence by the stockholders. New senior management people should be hired who are not from within the FCS but have the capability and expertise to help sort this thing out.

If there is in fact the severe financial stress that many people say exists in the FCS, then there should be an immediate liquidation of all nonessential physical assets throughout the entire FCS. Everything including all the offices should be moved to more modest quarters nationwide. Selling off all the fancy buildings that have been purchased or built in the last ten years or so would bring in a significant amount of money and give the stockholder renewed confidence in management.

We want an immediate full scale Congressional investigation to determine the true financial strength of the Farm Credit System. Because the failure of the FCS has such enormous national consequences, Congress must determine whether or not it is in fact solvent.

To maintain confidence in the system by the user as well as the lender, Congress should formally guarantee the bonds and the B-stock at all levels. This is not spending money, this is conserving money because if the FCS fails it going to cost the Government a lot more money.

Congress should clarify the legal status that they intended for the FCS. Is it a Federal entity that is to be dealt with in Federal Court, or is it truly a private corporation, and if so should it have all rights and privileges and responsibilities of a private corporation?

There should be regular outside external audits at all levels with reports issued to stockholders as well as to Congress. Stockholders should not only receive these reports on the financial condition of their local PCA on an ongoing basis (more than once a year) but they should also be informed in detail on any changes in the structure or the financial condition of the FICB. Granted, many people will not read these reports, and many will not understand them, but it is the obligation of the FCA to provide this information in a form that will make members aware of what is at stake.

SUMMARY

The FCS is in trouble and no amount of rhetoric and denial can lessen that fact. Those that deny it are either attemping to fool others or they have fooled them-

selves. Our problems in the Western Montana PCA are not an isolated instance of financial mismanagement. They are part of a major national problem.

The financial strength of the entire FCS must be determined. This cannot be done without intervention by Congress in the form of indepth congressional hearings and a system-wide, independent audit. Depending on the outcome of a congressional investigation, we would then recommend to Congress that they take whatever action is necessary to restore both the confidence and financial strength to the system at all levels.

Most importantly, to us in Western Montana, and we believe to the system as a whole, is to restore the confidence of the borrower/user/member/stockholder in the system by redeeming our B--Stock in the Western Montana PCA.

[The following material was inserted by Mike Roth, Western Washington Production Credit Association:]

TESTIMONY OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION, BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION AND CREDIT, MARCH 26, 1985

Mr. Chairman and members of the subcommittee, on February 7, I shared with you some recommendations contained in a resolution by the Federal Farm Credit Board for dealing with stress in agriculture. Today, I would like to follow-up with some detail on those recommendations, describe some actions we have already taken, and reiterate our commitment to work with Congress and this Administration to develop responsible and constructive intermediate and longer term measures for dealing with the crisis facing the agricultural sector.

A great deal has occurred since I last appeared before your subcommittee. First, FCA strongly supported efforts to provide emergency credit assistance to help farmers obtain financing for spring planting. Specifically, we submitted a list of recommendations to Secretary Block for improving the Debt Adjustment Program to remove what we viewed as obstacles to participation by private lenders. We shared those recommendations with the members of the Agriculture Committee by letter dated February 21. We are pleased that some of these changes have been implemented.

One recommendation was to modify the Approved Lender Program to provide blanket eligibility for Farm Credit System institutions. We commend Rep. Dan Glickman for his successful floor amendment incorporating this concept into the Emergency Agriculture Credit Act passed last month. While this measure did not ultimately become law, some of its key provisions have subsequently been implemented. Earlier this week, I was pleased to join Secretary Block in announcing changes in the regulations for the Farmers Home Administration's Approved Lender Program that permit most Farm Credit System lending institutions to qualify. These changes came about after extensive negotiations between USDA and FCA. We are hopeful that Farm Credit System institutions will participate in this program and that their participation will increase the number of farmers who will benefit from the program.

In addition to our recommendations on immediate measures to assist hard pressed farmers, the February Federal Farm Credit Board resolution identified three additional concepts for further study. First, the idea of creating some federal mechanism to relieve private and cooperative lenders from some of the burden of carrying nonperforming assets. Second, the extension of intermediate enforcement authorities to FCA to permit quick and decisive action to correct unsafe and unsound practices in the future. And, third, the enactment of FDIC-type insurance to enhance public confidence in the strength and stability of Farm Credit System institutions. I would like to address each of these points.

The FCA endorses the concept of a federal mechanism to protect against market distortions from liquidation of nonperforming assets. We believe that the volume of such assets that will come onto the market in some areas will otherwise cause an overadjustment in asset prices, destroying the balance sheets of salvageable farm businesses. A second effect of carrying nonperforming assets is to drive up the interest costs on those loans that are performing. The Farm Credit Council, the trade association representing the cooperative lenders of the Farm Credit System, is developing a proposal to create an Agricultural Conservation Corporation. We shall carefully study the details of this plan when it is completed and we shall be happy to comment on it at the appropriate time.

On February 14, we submitted to the committee draft legislation to provide FCA with the intermediate enforcement authorities needed to effectively carry out our regulatory responsibilities. In addition, today I will outline for you the concept of establishing a Farm Credit System Insurance Corporation, similar to the FDIC, to insure member stock in Farm Credit System institutions.

Mr. Chairman, the draft legislation we have delivered to you would grant FCA the same intermediate enforcement authorities currently possessed by other federal financial regulators, such as the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration. They would increase our ability to protect shareholders of FCS institutions, while granting the institutions increased freedom from FCA regulation of ordinary business decisions and protect their right of appeal of such FCA actions.

The enforcement actions provided for in the legislation are to be conducted in accordance with the Administrative Procedures Act. These requirements permit persons or System institutions against whom an administrative action is commenced to obtain a formal hearing, on notice, and on the record, and to obtain judicial review of final agency actions.

Presently, FCA has limited enforcement powers some of which are only used as a last resort. It may, with the concurrence of the district board, require merger when it determines that an association has failed to meet its obligations or to conduct its operations in accordance with the Act. And, upon default of any obligation, a farm credit institution may be declared insolvent by the Governor and a conservator or receiver may be appointed. It may also approve the salary of chief executive officers of the banks, and approve bank participation and terms on security sales.

Action can only be taken after the damage has been done. Thus, unsafe and imprudent practices, even if identified by FCA, cannot be remedied under current authorities until the practices result in insolvency.

The Farm Credit Administration also possesses a variety of "approval" authorities, including the authority to approve System bond sales. These, together with its supervisory activities, are additional tools available to FCA. None of these tools carry the force of law; they are tools of persuasion. The Farm Credit System, however, is too large and the times too perilous to permit the luxury of regulation by consensus.

The intermediate enforcement authorities we seek are essential if FCA is to carry out the mission assigned to it by the Congress. The FCA's enforcement and approval authorities served it well when the FCA was a "program administrator." But times have changed; the Farm Credit System has matured. The new authorities we seek will formalize the appropriate arms-length relationship between FCA as regulator and System institutions as private lenders. The new authorities are needed now to deal with today's crises.

These new, intermediate enforcement authorities would permit FCA to stop or alter a course of action that is unsafe, unsound, threatens the strength and stability of financial institutions, or violates the law, rule, or regulations.

Let me now turn to a related problem and some concepts we are studying for its solution. When Farm Credit System institutions fail, the implications for their borrower-members are more serious than they are for the clients of failed commercial banks. Borrower-owners of FCS institutions lose twice: first, because credit services are disrupted, and second, because they are owners of the failed association. Borrower-owners could lose the value of their stock investment when System institutions fail.

To address this problem, we are exploring the concept of an FDIC-type program to insure the value of stock contributions made by borrowers from System institutions.

The threat, even the rumor, of pending liquidation of a System institution can cause its borrowers to refinance their loans through other lenders and redeem their stock in order to avoid partial or total loss of its value. Moreover, we are concerned that borrowers are leaving their institutions throughout the System because if the fear that at some future date their stock investment could be in jeopardy.

The most creditworthy borrowers of a threatened institution are in the best position to refinance their loans elsewhere. The exodus of these borrowers can cause a substantial diminution in the financial strength of the institution at a time when the association can least afford it. The interest rates that must be charged remaining borrowers inevitably increase. To prevent such "runs" on associations is an objective of this insurance.

Most importantly, insuring the stock purchases of member-borrowers would serve to bolster public confidence in an important component of the nation's financial system. We are all aware of the institutional consequences of shaken public confi-

dence in the safety and soundness of financial institutions. Recent events in Ohio involving savings and loan associations remind us once again that the viability of financial institutions is founded on public trust and confidence. Insuring the stock of borrower-members will protect individuals by making borrowering from a System institution as safe as being a customer of a commercial bank.

The concept we will be discussing with the Federal Farm Credit Board at its April meeting next week, is modeled after those insurance funds administered by other financial regulators, such as the Federal Deposit Insurance Corporation, the Federal Savings and Loan Corporation, and the National Credit Union Administration.

The fund would be administered by the Governor of the FCA as a function and responsibility of the Farm Credit Administration. The Governor would have authority to establish the appropriate level of funds assets, would establish and adjust premium rates as appropriate, would authorize payment of claims, and would remove insurance coverage for cause. As with other insurance funds, the Governor would be authorized to exercise emergency Treasury borrowing authority for the limited purpose of meeting claims payments, should fund assets be inadequate to meet indemnity claims.

The fund would initially be capitalized by transferring $260 million appropriated in two Department of Treasury funds for the purpose of permitting the Governor of the FCA to purchase stock in System institutions on an emergency basis. The fund would be augmented by premium payments made by primary lending institutions of the System. Fund assets would be deposited with the Treasury and would earn interest. Indemnity claim payments would be made from fund assets, backed by Treasury borrowing authority. Amounts required to initially capitalize the funds would, as fund assets increased over time, be returned to the Treasury.

A pro-forma fund operation model shows that initial capitalization of $260 million will be adequate to meet anticipated indemnity claims. In addition, premium rates sufficient to repay the initial capitalization and to recapitalize the insurance fund can be set at levels that should not materially effect borrower interest rates.

As always, Mr. Chairman, we stand ready to work with you, the Administration, and the Farm Credit System, to further explore this concept and its ramifications. We will be examining it in great detail with our Board next week and intend to widely share our findings and conclusions. Recognizing that these are perilous times for agriculture and the financial institutions that service them, and decisive consideration of responsible proposals is necessary.

We urge that you move forthwith toward enactment of the legislation we have submitted to grant FCA intermediate enforcement authorities. The System cannot afford to continue to take hundreds of millions of dollars in losses while its regulator lacks the power to take effective actions to protect the public and stockholder interests from unsound practices of individual institutions. Neither can the System affort to wait very long before taking decisive action that will give individual borrowers the confidence to continue to do business with their local production credit and federal land bank association.

In closing, I wish to comment on two legislative efforts that have come before your committee in recent weeks. First, let me address lenders' rights in mortgaged commodity transactions. The Federal Farm Credit Board shares the concern about the growing incidence of conversion of crops and livestock pledged as collateral for loans. The question of shifting the risk of loss from the buyer—where it now rests under Section 9-307 of the Uniform Commerical Code—to the lender has been addressed by a number of state legislatures, and they have adopted various alternatives. To date, no single response has proved to have wider applicability or acceptance. Experimentation needs to continue. Therefore, at the moment, the issue is best left to state rather than Federal action, taking into consideration the following principles:

(1) Congress should leave to the state the responsibility for adjusting the relationship between buyer and lien holder;

(2) Lenders should recognize their responsibility to reduce the risk to buyers to the greatest extent feasible through prudent lending practices; and

(3) Buyers should not be absolved of liability for loss where a farmer or ranchers converts proceeds from the sale of crops or livestock pledged for payment of a loan and subject to a perfected lien.

Finally, FCA opposes H.R. 1217. It would effectively weaken the Farm Credit System by breaking it up into its separate banking groups at a significant cost to borrowers. It would reverse a trend toward better coordination in providing services to borrowers that has been taking place for sixty years. It would disrupt the coordinated credit and financial services in the majority of the Farm Credit districts that have already implemented joint management at bank and association levels.

That concludes my statement. I would be happy to answer any questions you may have about the matter we have discussed.

PLAINS, MT, *April 8, 1985.*

U.S. SENATE AGRICULTURE COMMITTEE

Subject: Farm Credit System (FCS) Bonds.

DEAR SIR OR SIRS: All the ancestors of myself and my wife have been in America for more than 250 years (some since 1659). Our ancestors fought and died to build this country. In the struggle for unity, strength, and peace they developed the great American society. We are the inheritors of this great past. In our hands lies the shape of the future.

Now comes our government and it loan sharks, blackmails, defrauds, lies, cheats, and steals. It matters not that the court declare the B-Stock to be venture capital and not interest, because in fact it is and was the cost of borrowing money which all dictionaries defines as interest. This is what 90 percent of the borrowers believed and is also a fact.

The federal courts may void the law of gravity or declare the earth flat or that two plus two equals six. What is important is the facts and what people believe.

Montana farmers are a peaceful and loyal lot but they have enough sense of justice that they will never forgive or forget that an instrumentality of the federal government cheated them by adding 10 percent to their loans. They never received any money or anything of value. There were no stock certificates and no disclosures as required. There was no benefit, nothing that could be sold, no consideration given the truth in lending laws, the SEC and common ethics. It was just an automatic debit and credit as explained by the PCA in the below paragraph, taken from a release by the PCA, entitled: PCA—"member transaction summary" mailed to all borrowers in 1984. Below is a verbatim copy.

"The level of Stock Ownership required for membership is automatically maintained by the computer and stock may be issued or retired on each transaction. Such computer generated stock transactions are described as "Automatic Stock Issue" (or retire). The amount of stock issued or retired is automatically added to or subtracted from your loan principal balance."

In late November of 1984, PCA was descended upon by a corps of hatchet men who down graded all loans and declared perfectly good loans as problem loans or the borrowers as insolvent. Land was down-graded as much as 80 percent. Well, it is the same land and will grow the same crops.

Farmers don't want subsidies. They want parity, a fair shake. Also even without parity and with low farm prices and high interest many farmers could and would make it. But there is no business anywhere in the USA that will not be insolvent if you lower the value of their security and assets sufficiently.

Also when you consider the B-Stock loss farmers are paying 26.9 percent interest or 27.5 percent, as I am paying that at present. If we had lived up to the security agreement they forced us to sign, we would be paying 141 percent interest considering the interest on B-Stock. These hatchet men moved in and grabbed all possible security and forced borrowers to sign quit claim deeds, refused to release loans when they were paid off. Certain insiders were able to cash out just before the B-Stock was frozen. But they are afraid to testify in court to this as they could lose their redemption funds. There is evidence for the above.

Also we have heard rumors of dispossession on 24 hours notice. That is, the borrower was told he could keep his car and house if he signed everything over to PCA within 24 hours.

In some instances, abstracts were examined back to 1890. Some cattlemen were asked so many details about their operations which one man described as including how many hairs there were on each cow and which way those hairs point.

Not many people know this but a person can sell his body. Hospitals and medical schools need and buy cadavers. They put a secret mark on the body and coroners know about this and notify the buyer on the death of such a person who has sold their body. My wife says for pete sakes don't tell these PCA hatchet men about this.

Seriously this new squad of hatchet men grabbed everything and were slick and smooth and learned in the art of delaying loans and keeping the farmers dangling so that after weeks or months of delay he was financially strapped and right up against the wall and would sign dozens of legal sized pages of deceptive, tricky, one-sided contracts that were so abstruse even attorneys require a lot of time to unsnarl them.

It's just like holding a double barrel shotgun in a man's belly and saying "Now, are you going to sign this mutually agreed contract representing a meeting of our minds?" And for this, the borrower is charged hundreds of dollars in attorney fees and other costs added to the bill.

At one time they were adding interest on interest and making all sorts of illegal compounding. Then they got scared and reserved a lot of it and didn't enforce a lot of it.

The B-Stock is in many ways similar to the old time now illegal add-on or scalping mortgage. This was done on a wide scale 50 years ago. You figure the interest for the term of the loan, add it to the principal and divide by the number of monthly payments. This effectively about doubles the stated interest; another way is to make a loan for 6 years and take the interest off in advance. Since a present interest rates, money about doubles itself in 6 years. The borrower never gets any money at all but owes the full principal immediately. Can't you tell something is wrong here? This is called "scalping" and is the way the B-Stock and revolving security agreements are made where the farmer pays back all money he takes in and then reborrows. This triggers 10 percent on the turnover. I signed such terms with the PCA. Interest would have been over 100 percent per annum. I have the papers and can prove this.

But what happens to me or to any individual is small potatoes. What is important is that there are hundreds and thousands of American farmers who have been lied to and swindled and who, if the B-Stock is not redeemed, will never forgive or forget and never again trust their government. This weakens our government and is asocial. We have enough things threatening America without this. I do not believe that revolution is possible or likely at this time, but I do believe the administration is summer fallowing and preparing the ground for *Regna nisi magna latrochinia* (Augustinus, De civitate Dei).

DAVID A. LAWYER.

PLAINS, MT, *April, 1985.*

U.S. SENATE AGRICULTURE COMMITTEE

Subject: Farm Credit System (FCS) Bonds.

DEAR SIR OR SIRS: It seems to me that when one appeals to Senators or Congressmen it is very likely that the person addressed will never see my letter. So, I am addressing you hoping that you find it of interest.

The Subject is the Farm Credit Bonds.

I phoned several stock and bond brokers in the Northwest and they all told me that Farm Credit Bonds sell on the Securities market and are guaranteed by the U.S. Government. Two persons told me they carried a triple "AAA" rating.

Now an attorney who specializes in this insists that they are no more guaranteed than the B-Stock which the PCA has just repudiated. Already hard pressed farmers in this area have had millions added to their debt and for these millions they never received anything of value at any time. They are paying interest on these levies and their security will not be released until they pay this money. This repudiation took place without warning. In fact just a few days before it was repudiated the "B" stock being then forceably sold to borrowers was represented as redeemable.

It occurs to us that, if these "administrators" can repudiate the B-Stock without warning, they can also repudiate the Farm Credit Bonds.

The Farm Credit System (FCS) borrows yearly over 90 billion dollars in the securities market and they are the largest seller of bonds next to the U.S. treasury. I have been told that there is an implied warranty to the FCS bonds; but no real warranty, no enforceable warranty. Well, there certainly was an implied warranty to the B-Stock. In 50 years PCA B-Stock has never failed to be redeemed; and anyone who suggested it might not be redeemed was branded a crackpot.

I am writing this to you because you should know that a repudiation of this magnitude (90 billion dollars) would collapse the whole financial structure of the U.S. This would be the greatest disaster ever to overtake the USA.

What is needed is a U.S. congressional investigation in depth, with hearings in Washington and in the field, especially, Montana, Idaho, Oregon, Washington, Nebraska, Wisconsin, Minnesota, North and South Dakota. This should happen immediately. Let's have the facts from the people concerned.

In the meantime there should be a moratorium on foreclosures and the B-Stock debts should be removed (since it was never received and in fact that stock never actually existed; or if you prefer, it should be "redeemed." It is all a matter of sematics. The facts are immutable. If this is done farmers can go elsewhere and borrow.

Most farmers can't borrow elsewhere because they were only insolvent because the FICB grossly downgraded their security, destroying land and machinery values in the process.

Hoping to hear from you and that you will try to do something.

Sincerely,

ESTHER LAWYER.

DEMANDS BY WESTERN MONTANA PCA STOCKHOLDERS COMMITTEE OF THE U.S. SENATE AGRICULTURE COMMITTEE

1. Congress must force the Farm Credit Administration (FCA) to immediately redeem the "frozen B-Stock of the Western Montana Production Credit Association (WMPCA) and other PCA's in liquidation by activating the Revolving Fund or from other sources within the Farm Credit System (FCS).

Comment: Congress set aside $126 million for just such an emergency and these funds reside in the U.S. Treasury. The Governor of the FCA fails to activate this fund because it opens the door to further scrutiny by the Government of recent FCA actions.

2. Congress must immediately guarantee the member/borrower's B-Stock throughout the FCA and guarantee the Farm Credit System's bonds.

Comment: This is critical to maintaining the credibility of the entire FCS to both the borrower (stockholder) and the lender (bond buyer). Without guaranteed solvency the $90 billion/yr FCS may collapse and the consequences of this to the national economy would be catastrophic.

3. Congress must conduct a full-scale congressional investigation to determine:

A. If the FCS is being run with ". . . the objective of improving the income and well being of American farmers by furnishing, sound, adequate, and constructive credit. . ." (PL 19-181) as amended).

Comment: The stockholders believe that the FCS has been taken over and is being run for the benefit of the bureaucracy, not the farmers.

B. The true financial strength of the Farm Credit System:

Comment: The FCS has no regular outside audits, reviews or accountability and appears to be under very severe financial stress throughout the country, possibly on the verge of collapse. Yet, the FCA refuses to admit these problems are serious and is not dealing with them effectively.

4. Congress must immediately stop the adoption of the proposed FCA rules on Liquidations of FCA Banks and Associations. (Federal Register Vol. 50. No. 30 Feb. 13, 1985) until proper and extensive public hearings have been held and Congress has determined if the proposed rules comply with the objectives of the Farm Credit Act of 1971, as amended (PL 92-181).

Comment: The proposed rules fail to provide any accountability or representation by PCA Stockholders with respect to the disposition of PCA assets. They fail to provide due process during liquidation and no appeal procedures are provided for.

○

69-216 (64)